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**FINANCIAL INSTITUTIONS REFORM, RECOVERY AND
ENFORCEMENT ACT OF 1989, FIRREA, AND ITS
IMPACT ON THE FEDERAL HOME LOAN BANK
SYSTEM**

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HEARING

BEFORE THE

SUBCOMMITTEE ON

GENERAL OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON BANKING, FINANCE AND

URBAN AFFAIRS

HOUSE OF REPRESENTATIVES

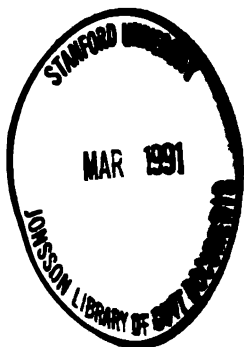
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FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989, FIRREA, AND ITS IMPACT ON THE FEDERAL HOME LOAN BANK SYSTEM

Wednesday, October 10, 1990

**HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GENERAL OVERSIGHT AND
INVESTIGATIONS,
COMMITTEE ON BANKING, FINANCE, AND URBAN AFFAIRS,
Washington, DC.**

The subcommittee met, pursuant to call, at 2 p.m., in room 2222, Rayburn House Office Building, Hon. Carroll Hubbard, Jr. [chairman of the subcommittee] presiding.

Present: Chairman Hubbard, Representatives Barnard, Flake, Parris, and McCandless.

Chairman HUBBARD. The Subcommittee on General Oversight and Investigations of the House Committee on Banking, Finance and Urban Affairs is now called to order.

Let me ask this favor of those of you in the back. You would sure help us if you all could move along the wall up here to this first chair to give room for more who might be coming in. Naturally, we would prefer to have this hearing in 2128 Rayburn Building. We requested that.

At one point, it looked like that was going to be possible because the housing conferees would be finished with their business by yesterday afternoon, but that just didn't work out.

They are meeting now. The housing conferees, the Senators and the House Members, are meeting in 2128, so, therefore, we are having our hearing in 2222, a rather crowded area.

I will probably say this more than once, but those of you in the back who would like to come on down along the wall here, it would be appreciated. Then when others come in, they won't think we are so crowded they cannot stay.

Congressman Stan Parris, the ranking minority Member, is on the House Floor right now waiting his chance to speak on a coin bill, which is under suspension.

We have 44 suspensions on the House Floor today. Hopefully, no one will call for a vote on all of them. It's possible during this month.

I am pleased to welcome our distinguished witnesses here today, and thank them for their willingness to testify before our subcommittee on the impact the Financial Institutions Reform, Recovery

and Enforcement Act of 1989, or as we have come to know this law, FIRREA, has had on our Nation's Federal Home Loan Bank System.

This is not the first time our subcommittee has turned its attention to this important issue. Indeed, almost 1 year ago to the day, October 11, 1989, to be precise, we held a similar hearing in which a group of diverse witnesses ranging from Federal Home Loan Bank presidents to representatives from the thrift, commercial banking, credit union and real estate industries tried to predict the long-term impact FIRREA would have on the Federal Home Loan Bank System.

Today's hearing will serve as an opportunity not only to evaluate the accuracy of the predictions made a year ago, but also to examine many of the current proposals for reforming the Federal Home Loan Bank System.

As members of this subcommittee are aware, FIRREA was signed into law by President George Bush on August 9, 1989. It was to have a profound impact on the structure and functions of the Federal Home Loan Bank System.

Most importantly, prior to FIRREA, the Federal Home Loan Banks were both fundraisers and regulators of the Federally-chartered savings and loan industry. Today, however, as you know, the Federal Home Loan Bank Board has been abolished, and the Office of Thrift Supervision has been created to act as the principal regulator of Federally-insured thrifts.

As I mentioned at our first hearing on this issue last year, FIRREA was the result of 7 months of intensive, and often hectic, negotiations in Congress, with the unfortunate result that many decisions had to be made without the benefit of hearings.

Today, we will examine the impact FIRREA has had on the Federal Home Loan Bank System and, in particular, how the situation has changed over the past year.

Many of the questions I would like to address today are the same ones we raised the last time we met to discuss this issue. In particular, we will address the issue of whether membership in the Federal Home Loan Bank System has been made sufficiently attractive for commercial banks and credit unions.

It has become clear that, given the annual fixed contribution the Federal Home Loan Banks must make under FIRREA toward the resolution of troubled and failed savings and loans, the only viable way for Federal Home Loan Banks to raise new capital and maintain current levels of dividend payments to their stockholders is through expanded membership.

Without attracting new members, and thus new capital, some observers are predicting the the Federal Home Loan Banks will soon be unable to meet their obligations under the thrift bailout provisions of FIRREA.

In this regard, we will examine a number of the proposals which have been put forward for making membership in the Federal Home Loan Bank System a more attractive option for those commercial banks and credit unions that have a proven record of dedication to home financing.

At this point, I might mention a press release we received from the Federal Home Loan Finance Board announcing that 16 com-

mercial banks and one credit union have been accepted as new members in the new Federal Home Loan Bank System. I might add that one of these banks is located in Mount Washington, KY.

Whether this is the beginning of a new trend we cannot say at this point, but it surely must be good news to our three Federal Home Loan Bank presidents, and we will ask their comments as well as the comments of our second panel of witnesses about this news.

As things stand today, the qualifications for membership imposed upon thrifts, commercial banks and credit unions are not uniform. Some have suggested that creating a set of uniform criteria for all qualified applicants would result in a significant increase in new membership.

However, should Congress decide to implement uniform membership standards for all, we must make certain that any increase in membership will not be offset by a weakening of the Federal Home Loan Bank System's dedication to our Nation's housing needs.

Balanced against the possible increase in the Federal Home Loan Banks membership for commercial banks and credit unions, concern has also been expressed that making the system more attractive might adversely affect the substantial amounts of FHL Bank stock held by those members who belonged to the system prior to FIRREA.

In other words, whatever reforms are implemented in the future, by far the most important duty of the Congress will be to insure that the low-cost funds made available by the Federal Home Loan Banks continue to reach America's home buyers and are not diverted for other purposes.

Another obstacle to Federal Home Loan Bank membership often cited by commercial banks is the possibility that Congress might once again tap the system for additional funds to aid in the resolution of troubled and failed S&Ls. What many of them fear is that once they have become members of the Federal Home Loan Bank System, and bought the requisite shares of stock, the government might be tempted to seize that stock in order to raise new capital for the Resolution Funding Corporation.

I would like to point out, however, that to my knowledge none of my colleagues in Congress has seriously suggested that this be done. In fact, just recently Secretary of the Treasury Nicholas Brady testified before the Senate Banking Committee that "the Federal Home Loan Bank System simply does not have the capacity to back substantially more Resolution Funding Corporation borrowing."

Further, last month Robert D. Reischauer, Director of the Congressional Budget Office, testified before the Ways and Means Committee that "Industry sources, including the Federal Home Loan Banks and savings and loan institutions, have been sufficiently drained that to seek more cash from them might seriously jeopardize the viability of the healthy portion of the thrift industry."

Despite such ostensibly reassuring comments as these, many potential members will be fully convinced only when Congress publicly acknowledges that the seizure of Federal Home Loan Bank stock will not occur.

Moving on to other issues I would like the subcommittee to address today, in October of last year I asked our witnesses whether they thought the 12 regional Federal Home Loan Banks would be unevenly affected by the enactment of FIRREA. Today, 1 year later, we are again asking our witnesses to address this question.

We will also raise the issue of whether a significant reduction in operating costs might be realized through the consolidation of the 12 regional banks into one Federal Home Loan Bank. I would be particularly interested to hear our Federal Home Loan Bank presidents' points of view on this proposed reform.

Another proposal which has received a great deal of attention is the idea of privatizing the Federal Home Loan Bank System. With that said, I would like to introduce our two panels of witnesses.

I know there are some here from out of state that don't normally attend hearings. When I said there would be 44 votes, and that they would all be at the end of the day, so even though we are not with the advantage of being in 2128, we are at the advantage of not having any roll call votes to interrupt our hearing this afternoon.

Congressman Al McCandless of California.

Mr. McCANDLESS. Thank you, Mr. Chairman.

I do not have any opening remarks. However, I would like to leave a thought with our panels for whatever remarks they may wish to make on this, and that is there appears to be an opposite reaction to what brought about FIRREA in terms of people who do the regulating to the degree that many of the users of financial institutions are finding it extremely difficult, even though they have the necessary credentials, as past borrowers does meet the criteria, but the regulators have so intimidated in many cases the banking and financial institutions, they are reluctant to do what would normally be a regular loan pattern.

If there is any comment on this, I would appreciate hearing it so that this, too, can be brought forward, Mr. Chairman.

Thank you.

Chairman HUBBARD. Thank you very much, Congressman McCandless.

Congressman Barnard of Georgia.

Mr. BARNARD. Thank you, Mr. Chairman.

And let me at the outset congratulate you on conducting this very important hearing today and assembling such a distinguished panel of witnesses, not only from the Federal Home Loan Banks, but from the other areas of banking interests in the country.

These hearings are very, very timely. It's been more than a year since the passage of FIRREA, and it's important that we monitor the impact of these changes and the requirements that this legislation places on the Federal Home Loan Banks. They were and still are one of the health components of the thrift industry.

A French Minister of Finance once described the art of taxation as the one of plugging the maximum number of feathers from the goose with a minimum of hissing. While the Federal Home Loan Banks are too polite to hiss, I am concerned that they are missing more feathers than is commensurate with sound policy.

Earnings in capital have both been reduced by the system and for the system. No one disputes that the banks should pay a sub-

stantial amount toward the resolution of problems in the savings and loan industry.

Congress also saw fit to statutorily impose new housing responsibilities which place further demands on their earnings. While we also included some measures designed to attract new members and sustain the earnings of the banks, I think that as we proceed with the oversight process, there will be significant questions as to whether these measures have been successful.

I hope that these hearings will give us an idea as to how we can increase flexibility in terms of the banks contribution to savings and loan resolutions, and housing, while stabilizing existing membership and attracting new members.

It seems to me that at some point we have to say that enough is enough in terms of what the banks can continue to contribute. Existing and prospective members are right to be concerned over the potential reductions in the value of their paid and capital that if taken far enough can amount to confiscation.

Mr. Chairman, I again applaud your leadership and the panel that has been assembled today and look forward to the further discussions of this subject.

Chairman HUBBARD. Thank you very much, Congressman Barnard.

We now call on our friend and colleague, Congressman Floyd Flake of New York.

Mr. FLAKE. Thank you very much, Mr. Chairman, and we commend you for holding these hearings.

As always, the Committee on Oversight and Investigations looks very deeply at those issues which are of great concern with the banking industry, and I think that you have chosen an appropriate one for this day, considering that all of us have in the back of our minds some consideration and concern about what is going to happen in the future, and particularly are we concerned about the Federal Home Loan Bank System.

I think all of us have agreed that the system must continue. Hopefully we can create some means in which there is a greater attractiveness to it. I hope that in these hearings we will hear from those whose concerns we share. That will help us in the process of moving toward that end, and I look forward to hearing from those who have come to testify today, Mr. Chairman, and yield back the balance of my time.

Chairman HUBBARD. Thank you very much.

Again, I would say that Congressman Stan Parris, our ranking minority Member, wishes to be here, but he cannot be two places at once. And he needs to be on the House Floor when the bill he is interested in is taken up as one of the suspensions. He will be here later.

Our first panel is composed of three Federal Home Loan Bank presidents, two of whom I might add were testifying before our subcommittee last year on this same issue.

And these two are Charles Lee, Chuck, Thiemann, and Brian Dittenhafer. Chuck Thiemann is president of the Federal Home Loan Bank of Cincinnati. He is accompanied today by Brian Dittenhafer, the president of the Federal Home Loan Bank of New York; and

Robert E. Showfety, president of Federal Home Loan Bank of Atlanta. And again, it's Robert E. Showfety.

All three have experienced FIRREA's impact on the Federal Home Loan Bank System firsthand and are certainly qualified to testify on how things have changed since October of 1989.

So to, Mr. Thiemann and Mr. Dittenhafer and Mr. Showfety, we do appreciate your being here. We—I am embarrassed that I mispronounced your name. I had a contracts professor in law school who pronounced my name Hughbard for the whole semester. I didn't want to challenge him on it.

Mr. SHOWFETY. I had that same feeling.

Chairman HUBBARD. Before we hear our three witnesses, I would want to give our ranking minority Member, Congressman Stan Parris, a chance for his opening statement.

Mr. PARRIS. Thank you, Mr. Hubbard. I am delighted to be here, and I apologize to you and to the witnesses. We just completed consideration of a bill of mine on the Floor, which I felt it necessary to be present over there, and I would ask unanimous consent that my entire statement be placed in the record and make just several brief comments.

Chairman HUBBARD. Without objection.

Mr. PARRIS. Thank you.

FIRREA placed an enormous financial responsibility on the Federal Home Loan Bank Board; we are all aware of that. They are required to use their retained earnings to purchase REFCORP stock, and they are required to establish the fund for the affordable housing programs that subsidized interest rates on member institutions provide housing credits for low and moderate income families and so forth. They are required to pay approximately \$300 million on REFCORP borrowing.

Now all of that may be good, it may be bad. That is not the point. The point is that is the obligation under the law. All of these strains come at a time when Federal Home Loan Banks appear at least to be able to carry those additional burdens. Continuing failures in the savings and loan industry and an overall reduction in capital and net earnings of the thrift industry must, however, have an impact on the Federal Home Loan Bank System.

And it raises the question rhetorically of how much can the system withstand before its capital position dips below an acceptable level?

Notwithstanding these financial obligations, it does appear that the banks are healthy and strong. I think that is an important point for those nonthrift financial institutions that are or may be considering the possibility of joining the Federal Home Loan Bank System. The system is hopefully strong and we believe it's able to continue to operate for the benefit of its membership.

Finally, I agree that we must continue to review, and I congratulate you, Mr. Chairman, in this regard. We must continue to have oversight on the activity of the membership requirements for nonthrift institutions to prevent exclusion of strong financial institutions from joining the system.

We are correct in broadening the scope of financial institutions that are eligible to join the system; however, it now appears to be some concern that mortgage lending requirements and the manda-

tory purchase of stock for nonthrift institutions may be burdensome, if not unreasonable.

Allowing more institutions to join the system will increase the revenue of the banks, provide an additional source of credit liquidity for a diverse range of Federal institutions, but it's not without its problem areas. Therein lies the problem, and in my opinion, justifies the continued oversight.

I look forward to hearing the testimony of our witnesses. I appreciate your generosity, Mr. Chairman, and I do once again apologize for being late to the hearing.

[The prepared statement of Mr. Parris can be found in the appendix.]

Chairman HUBBARD. Thank you, Congressman Parris.

One reason I am kind to him, he's my Congressman out in Fairfax, VA; and we have problems out there, and we need his help from time to time.

Now, Chuck Thiemann, accompanied by Mr. Dittenhafer and Mr. Showfety. Before you start, Chuck, who is going to win the World Series?

Mr. THIEMANN. The Reds, very easily.

Chairman HUBBARD. I agree.

Thank you very much. Go ahead.

Mr. McCANDLESS. There is another opinion in the room, Mr. Chairman.

Chairman HUBBARD. Excuse me, Mr. McCandless.

Mr. McCANDLESS. It has Athletics in the name.

Chairman HUBBARD. Thank you, Congressman from California.

STATEMENT OF CHARLES LEE THIEMANN, PRESIDENT, FEDERAL HOME LOAN BANK OF CINCINNATI, ACCOMPANIED BY BRIAN D. DITTENHAFFER, PRESIDENT, FEDERAL HOME LOAN BANK OF NEW YORK AND ROBERT E. SHOWFETY, PRESIDENT, FEDERAL HOME LOAN BANK OF ATLANTA.

Mr. THIEMANN. Thank you, Mr. Chairman. We certainly appreciate your invitation today and the opportunity to share with you our views on the condition and prospects of the Federal Home Loan Bank System.

The basic message that I hope to convey is the Federal Home Loan Bank System remains a financially sound institution with a strong capital position and the potential to meet its responsibilities to support housing finance for every income level in our society.

We also, however, face some challenges. Since the passage of FIRREA, the Financial Institutions Recovery, Reform and Enforcement Act, we have experienced substantial reductions in both the level of assets and income of the Federal Home Loan Bank System.

Some of these reductions were expected. The capital requirements contained in FIRREA for thrifts and the transfer of insolvent institutions to the RTC, Resolution Trust Corporation, were expected to reduce borrowings from the Federal Home Loan Bank System.

That has certainly occurred. Advances have declined significantly and net income has been reduced by approximately 24 percent in the year following the passage of FIRREA.

These reductions, while not presently threatening to the stability of the system, would prove to be most disconcerting if they were to continue. We believe that the shrinkage in the asset base within the thrift industry is far from complete. But we are confident that the bank system can weather this period of transition.

What the system is able to accomplish after a period of 2 or 3 years will depend in large part upon the actions which Congress and the administration take to allow access to the services to which the Federal Home Loan Bank System is dedicated.

The bank system is a unique source of intermediate and long-term funding in support of housing finance. Our mission as financial institutions has always been to support housing finance. We are collateral lenders and lend primarily against the mortgages and mortgage backed instruments which member institutions hold.

We have a liquidity responsibility to members, but our main role has always been to add to the supply of housing finance by making loans to members secured by their own mortgage holdings.

We also have long embraced programs targeted specifically to low and moderate income families. The Federal Home Loan Bank System was a cofounder of Neighborhood Housing Services and introduced the Community Investment Fund in 1979, which created some 572,000 units of low and moderate income housing.

FIRREA specifically charged the Federal Home Loan Bank System with the responsibility to develop and administer the affordable housing program and to maintain a community investment program.

The first year of the affordable housing program has been a tremendous success, of which each bank individually and the bank system collectively is very proud. The challenges to the Federal Home Loan Bank System revolve around the reduction in the thrift industry's participation in borrowing from the system and the fixed nature of the transfers required to REFCORP.

As our net income is reduced, these costs become a greater percentage of our revenues, which in turn reduces our ability to pay dividends to members.

Expanded membership is the only realistic source of increased earnings. The potential can only be realized if some of the impediments to new members joining the bank system can be removed.

Two burdens which the bank system currently bears are fears over further legislative action which would take or reduce the value of paid-in capital, and the additional costs which most new members must pay to borrow from the Federal Home Loan Banks.

The first issue could be resolved by Congress simply declaring that no further requirements will be placed upon the bank system, which would impact the value of the paid-in capital.

The second issue would require legislative action, which would equalize the capital requirement for borrowing for all our members.

In your invitation, you raised several issues which you wished us to discuss. One is the attractiveness of bank system membership to commercial banks and credit unions. There are currently 30 new Federal Home Loan Bank members and 40 applications pending.

The bank system is attractive to an array of commercial banks and credit unions, and these numbers will grow. However actions

which would reduce the implicit cost of borrowing from the bank system would improve the attractiveness of the system, and more importantly, would provide additional access to affordable housing program monies and greater support of housing finance.

The uneven conditions of membership and access to borrowing currently included in the law are unfair to both current thrift members and a deterrent to many potential new members.

We think that the conditions for membership could stand a review.

You also asked that we comment on the uneven effects which FIRREA may have had on the bank system. I would note that all Federal Home Loan Banks have been required to transfer retained earnings to FICO and REFCORP. Each has been subject to lending and asset reductions, and with only one exception, each has seen a substantial reduction in net earnings.

All have suffered reductions in their net interest earnings. The transfer of retained earnings is one of the more uneven effects among the banks, due in part to the inconsistency between the allocation of the assessments and the distribution of earning assets.

While the bank I represent has suffered one of the greatest percentage losses of retained earnings, I cannot offer an alternative that would be accepted as preferable by all.

The other effects on the individual banks are associated with the uneven pace of the transfer and resolution of insolvent thrifts in each of the districts and the different economic conditions which exist in the various regions of the Nation.

We do not like the uneven impact of FIRREA, but I do not think we have a superior suggestion to make.

Finally, you asked that we comment on the number and location of the Federal Home Loan Banks. There have been suggestions in some quarters that consolidation would materially improve the net income of the bank system.

I would suggest to you that it's much too early in the transition of the bank system to determine what is the preferred structure. We have just begun to expand in meaningful numbers the membership of commercial banks and credit unions. With adjustments to the conditions of membership and access to the services of the bank system, the pattern and geographical groupings of members may change dramatically.

The banks are making the necessary adjustments to meet our mandates. Before we move aggressively to alter the system, which has served so well for 58 years, we should allow some period to determine where we are headed.

As I said in my opening comments, I feel confident that the Federal Home Loan Bank System remains a financially strong, well capitalized, responsible institution. With some modest changes in the conditions of membership and access to the services of the bank system, the bank system would be in a strong position to meet its responsibilities to help fund the housing needs of all of our citizens.

Thank you, Mr. Chairman, and we will now be pleased to answer any questions that you may have.

[The prepared statement of Mr. Thiemann can be found in the appendix.]

Chairman HUBBARD. Thank you very much. We appreciate your testimony, and know that you and those who accompany you will try and answer our questions.

In all fairness to my colleagues on this subcommittee whom I deeply appreciate, we will all take 5 minutes, and then we can go another round. So each person can know that I will ask the staff to notify us when our 5 minutes is up.

Mr. Thiemann, it has been alleged that the nonvoluntary members of the Federal Home Loan Bank System, in other words, those savings and loans which belonged to the system prior to the enactment of FIRREA, would be disadvantaged if commercial banks and credit unions joined in large numbers, the reason for this being that since the commercial banks and credit unions would be voluntary members and thus able to leave the system at will, Federal Home Loan Bank policy would be made to submit their needs and not those of the core members who no longer have the right to operate out of the system.

Would you care to comment on these concerns?

Mr. THIEMANN. Certainly, Mr. Chairman.

Until the passage of FIRREA, of course, the bank system membership was limited to thrift institutions, savings and loan associations, mutual savings banks, and, of course, insurance companies were also permitted to join.

With FIRREA, however, the whole focus was changed in the sense that the Congress and FIRREA said to the Home Loan Bank System, you are now the Nation's housing bank, and you should serve all regulated lenders. And so they included both commercial banks and credit unions. That is part one.

Part two, I think it's time for the Congress to review the membership standard, not only for new members, but also current members; and we should have some kind of uniform membership that applies across the board to all members. And, obviously, that is the prerogative of the Congress, and that can only be accomplished legislatively.

Chairman HUBBARD. Would you support a voluntary membership in the Federal Home Loan Bank System?

Mr. THIEMANN. I think long term it's absolutely essential, and this is a personal opinion, that we do have voluntary membership.

I do think, however, in the short run, we need some kind of transition period to get over several of the problems that we have in terms of our earnings, the debt that we have outstanding, and what the bond indenture requires us to hold in terms of stock.

So I think it's a very noble objective and I think one that we should be headed toward, but in the short run, there will have to be some kind of transition period.

Chairman HUBBARD. What sort of membership and stock requirements would be used?

Mr. THIEMANN. Well, again, a personal opinion. I think one can make an argument that anyone that wants to become a member of a Home Loan Bank should pay some price, and that could be worked out in terms of some kind of stock holding. That is kind of an entry level design.

Number two, anyone that would like to set up a line of credit would also be required to pay some type of fee, and you could also translate that into stock holdings.

Thirdly, anyone who does borrow should also pay a little extra, and in all three of those thresholds I think can be converted into capital stock holdings.

Chairman HUBBARD. Mr. Dittenhafer or Mr. Showfety, would you all like to comment on these first set of questions?

Mr. DITTENHAFFER. I think I would like to comment on the voluntary membership, Mr. Chairman. Thank you for the opportunity, and again, these are my personal views.

The Federal Home Loan Bank of New York has had the experience of having voluntary memberships for a number of years because of the formerly FDIC insured savings banks in our district.

Indeed, at the time of passage of FIRREA, 40 percent of the stock in our bank was owned by these FDIC insured institutions who were voluntary members. The Federal Home Loan of Boston has an even greater percentage of stock owned by these voluntary members.

I think the record would show that the membership of these voluntary institutions, those who were not required to be stockholders of the bank, has benefited not only the banks themselves but our required stockholders. The earnings that we have had on those borrowings have enabled the Bank to pay dividends to all of our stockholders.

I think the voluntary membership has been beneficial to all of our stockholders.

Mr. SHOWFETY. Mr. Chairman, I would agree with that, also, and just emphasize the point that it expresses my view, but I think that is an issue where you wouldn't find 12 bank presidents agreeing. I have advocated that we should be moving in that direction, since FIRREA was passed, because I think in fairness to our existing stockholders, they should be treated the same way as the new ones that we are out trying to recruit.

So, yes, I would agree with that.

Chairman HUBBARD. My time has expired.

Congressman Parris.

Mr. PARRIS. Thank you, Mr. Chairman.

As I understand it, gentlemen, membership in the Federal Home Loan Bank allows various financial institutions to secure long-term mortgage funds from your institutions at attractive rates that better balances assets and liabilities. You offer correspondence services, process NOW accounts, demand deposit insurance services, account reconciliations, security safekeeping, disbursement services, your wholesale correspondents, you do a lot of things for a member bank. That is the good news.

The bad news is that it costs them some money. My question very simply, Gentlemen, is on Page 431 of the FIRREA Conference Report of 1989, it says in part, of the sums that I referred to in my previous remarks, the REFCORP bonds, the 300 million of capital this year, and so forth, if these sums, meaning obviously those sums, are contributing to the financial instability of the bank, meaning your bank, banks meaning the Federal Home Loan Bank System, may apply to the Federal Housing Board for temporary

suspension in determining financial instability, the Board must consider the factors such as earnings and substantial decline and membership capital, and so forth.

And my question to you is, have there been any temporary suspensions? If not, do you anticipate any in the near future? Are all of the 12 banks alive and well, or have some of them begun to show a little strain?

Mr. SHOWFETY. There have been no suspensions, to answer the first question. I am not aware of any bank any time in the near future that would contemplate having to request a suspension.

The banks are alive and well. They are healthy. Their capital ratios continue to be strong. Our concern is going forward with the financial obligations that have been imposed on us. We want to be able to remain strong in order to attract additional stockholders.

Mr. PARRIS. Exactly. So what you are saying is that the things that we did to you in FIRREA, including the contribution of capital and all of these other things that have been mentioned, have not as yet been fatal. They weren't fun, but they weren't fatal.

Mr. THIEMANN. That's very true. In fact, if you will recall, the Federal Home Loan Banks were the only government-sponsored enterprise which received a triple A rating from the rating agencies. So in that sense, we clearly are very strong at the moment.

Our concerns are directed more toward the future and what we will look like in 3 years or 5 years, and that is why we suggested certain changes that needed to be made.

Mr. PARRIS. And obviously, if we continue to impose additional burdens, you will look less well in 5 years than you look now. That is the bottom line; isn't it?

Mr. THIEMANN. Very clearly. And the major element which most of you have addressed, the major element in all of this is when you go out and talk with a prospective new member, the first question that is always asked is will Congress come back and confiscate stock?

And to the extent that that question can be answered in the negative, no, Congress will not touch paid-in FHLBank capital, goes a long way toward attracting new members.

Mr. PARRIS. Well, I would hope that continues to be the case, and my time has expired.

Thank you.

Chairman HUBBARD. I remind my colleague, we will be taking a second round to see if there are other questions.

Congressman Barnard.

Mr. BARNARD. Mr. Thiemann, what other projections of the Federal Home Loan Banks collectively as to how the further shrinking of the savings and loan industry will affect the banks collectively, as well as individually?

I mean, it's estimated, for example, that what, we have about 3,000 savings and loans now, or less than that? It's predicted that—well, there are 900 in 1990, I think, that are somewhat subject to—we are talking about maybe a level of maybe 2,000 savings and loans as far as that particular—how is that going to affect the Federal Home Loan Banks?

Mr. THIEMANN. Well, I think the way that will affect us, obviously as you transfer additional savings and loans into the RTC and

they are disposed of, since most of them today are being disposed of not to other thrifts but to commercial banks, our capital stock base continues to decline.

You also have the factor, and where because of the capital requirements imposed by FIRREA, the healthy part of the thrift industry, and that is still a big part of the thrift industry, is scaling back because it needs to meet the capital requirements.

One of the problems with that is you have to ask yourself what impact does that have on the supply of housing finance nationwide. Obviously, under FIRREA, because we can now have commercial banks and credit unions as members, the potential for improving the supply of housing finance exists.

The only way that the Home Loan Banks can improve their earnings, is to acquire new members, because as you suggest, we may end up with maybe 2,000 thrifts. That is a much smaller asset base.

Mr. BARNARD. Well, it disturbs me when I look on your Attachment One that the real effect that you are experiencing is in retained earnings. Your retained earnings in 1 year have dropped by 81.85 percent. That shows me, if I understand financial statements, that you are not going to be able to exist much longer under the present program.

Tell me I am wrong.

Mr. THIEMANN. What FIRREA did to us was to simply confiscate the entire retained earnings of the Federal Home Loan Bank System, and that is roughly \$3 billion.

Mr. BARNARD. Well, how much did the affordable housing program really affect this condition?

Mr. THIEMANN. Very little. It's 5 percent of our net income that we are devoting to affordable housing this year. So that is just a drop in the bucket.

But when you consider we lost \$3 billion of retained earnings and what we could have earned on \$3 billion, if you take a 10 percent earnings factor, that is roughly \$300 million a year.

That is a lot of money.

Mr. BARNARD. On Page 9, and I don't know, maybe I am reading it wrong; but your opening sentence says, the affordable housing program was a major new effort for the Federal Home Loan Bank System.

Then you say in the next sentence, it differs from past programs in only one aspect.

Well, you know, when this bill was being considered, I thought this was a brand new obligation without any historical tradition in siphoning off the earnings to go into affordable housing. I thought what we were doing was taking your earning to supplement what we were not doing in Congress in providing enough money for affordable housing.

Mr. THIEMANN. I think that probably was the thinking of some of the Members of Congress, but if you look at the Home Loan Banks going back to the mid-1970s, we had our own housing initiatives that we put into place. We had a Community Investment Fund, for example, starting in 1979.

Mr. BARNARD. And what did that actually do? Did that reduce the cost of housing?

Mr. THIEMANN. The Community Investment Fund clearly, in the low and moderate income areas, made monies available that would not have been available without those programs, and these were subsidy programs.

Mr. BARNARD. But wouldn't it have been better in passing FIRREA, if we had expanded that program as opposed to a brand new program?

Mr. THIEMANN. Well, I have no way of knowing that. I do believe that the affordable housing program was, in fact, a success, certainly the first offering would suggest that.

The second offering has been way over-subscribed.

Mr. BARNARD. Well, it was a success, true enough, but did it contribute to what we were trying to do in FIRREA, and that is to provide a corpus to bail out failed thrifts?

Mr. THIEMANN. It really amounted to a piece of housing policy.

Mr. BARNARD. In other words, it did not—I mean, while it was a good program, nobody denies that; but at the same time, it really was not put in with the bill to accomplish what the bill's purpose was.

Mr. THIEMANN. No. The purpose of the bill obviously was to fix the FSLIC crisis, and this was a housing issue.

Mr. BARNARD. And as a consequence, it siphoned off money that could have been going into paying for the cost.

Mr. THIEMANN. Yes. It took the 5 percent in 1990.

Mr. BARNARD. My time has expired.

Chairman HUBBARD. In all fairness to Mr. Dittenhafer and Mr. Showfety and my colleagues to the left and right, how about Mr. Showfety and Mr. Dittenhafer, any comments as to any questions asked by Congressman Parris or Barnard?

Mr. SHOWFETY. I would like to make one comment regarding the question of our shrinking membership base. About a third of our outstanding advances are held by institutions which are not meeting the capital requirements. That, obviously, is an exposure that the system has, if we are not able to bring in institutions that can replace some of those lost advances that account for about 80 percent of the income of the system.

Mr. BARNARD. May I follow that up?

Chairman HUBBARD. Sure.

Mr. BARNARD. Isn't there some prohibition on your making it—of course, all of your advances are secured.

Mr. SHOWFETY. That is correct.

Mr. BARNARD. So therefore, there is no question about whether they are solvent or insolvent, in conservatorship or not in conservatorship.

Mr. SHOWFETY. Absolutely not. They are all fully collateralized.

Mr. DITTENHAFFER. Addressing the question of the shrinking customer base, I think you have to be concerned, looking down the road, that the borrowing customer base, which is where we make our money and where we provide the income to meet our REF-CORP and affordable housing obligations, is going to be shrinking among those institutions who have been traditionally the borrowers from the Federal Home Loan Banks, the thrift industry.

I think the entire sweep of change in banking right now is to provide a wider base of institutions funding housing, that is com-

mercial banks and credit unions both getting more and more into the mortgage origination business. We have to be concerned about our ability to serve that segment of the housing finance industry.

That is a primary concern that I have about the customer base we have right now and it's shrinking contribution to housing finance.

Chairman HUBBARD. Congressman McCandless.

Mr. McCANDLESS. Thank you, Mr. Chairman.

We talked through this afternoon about the shrinking base. How can we approach this from the point of view of the requirements for nonthrift membership to the system be less stringent without losing the intent of the bank to provide credit principally for mortgage lending?

To whomever at all?

Mr. SHOWFETY. I will lead off. I am sure the others have some comments, also.

It really addresses the stock requirements at institutions which do not meet the QTL test. For example, an institution that does meet the requirement has a stock requirement related to the amount of their borrowings, which is 5 percent of the amount of advances they have outstanding. By comparison, a commercial bank, for example, that qualifies for membership at a 30 percent QTL, Qualified Thrift Lender test, would have a stock requirement of almost 17 percent.

The lower that QTL ratio, then the higher the stock requirement. This is very vividly illustrated on a table which I will be glad to provide for you. For example, while the law provides that we can bring in institutions that meet the 10 percent test (commercial banks and credit unions) the stock requirement is 50 percent of advances. So from a practical standpoint, those institutions are not real potential customers, in my view.

Another example, in this district we have 1500 commercial banks that meet the 10 percent test. Only 20 percent of those have a 50 percent QTL, and they hold only 10 percent of the assets in this district. So to think that there is a lot of potential with the stock requirements such as they are, with the dark cloud hanging over us as to what the possibility of a confiscation of that stock is, it makes the job very difficult.

I will be glad to provide that information.

Mr. McCANDLESS. Thank you.

Mr. DITTENHAFFER. The second part of your question, Congressman, had to do with how do we make sure that the funds that the Federal Home Loan Banks are advancing are being used for housing?

In other words, how do we ensure that the funds that we are lending are going to housing. FIRREA added another test to law, and that is that we have to have mortgage collateral before we make new loans to any of our members.

Before we make a loan, the member has to have made a mortgage loan and bring that to us as collateral. That is the best way that I know of to make sure that the funds we are lending to a thrift or commercial bank credit union are actually using those funds to finance home mortgages.

Mr. McCANDLESS. We have the savings and loans, we have the commercial banks, and we have the credit unions, all of which we have talked about here. To a degree, there is a different accounting system, a different, in the case of the credit union, a different insurance fund.

Does this pose any kind of a problem relative to the ability to establish assets versus liabilities and so forth when there isn't a generally accepted accounting practice among all three?

Mr. THIEMANN. No. I really, Congressman, don't think we need to worry about that for the simple reason as Congressman Barnard pointed out, we are collateral lenders, and no Federal Home Loan Bank has ever lost one penny in terms of its lending because they are collateral lenders.

Mr. McCANDLESS. Do you do an assessment of your own collateral, or do you take the institutions figures for the value of that collateral?

Mr. THIEMANN. Oh, no, we do our own assessment; and in fact, we mark to market every month. So we are right up to date on that.

Mr. McCANDLESS. Okay.

Many people claim that currently we are in some type of a recession, particularly as it relates to the real estate market; and the fact that it will continue to soften in the months ahead, giving the importance of the housing industry through the success of savings and loans. How will the continued decline in the real estate market affect the bank system?

Mr. THIEMANN. Well, any time that you have a decline in housing, it will affect the Bank System in the sense that there is less demand for our advances. Housing is a cyclical industry, always has been, and we have gone through these temporary periods where a demand for advances was down, for the simple reason that we were going through the bad part of the housing cycle.

But we would expect, after a period of a year or two, housing will improve. We need to stand ready at any time to finance housing through our advances. I mean, we can have a national housing recession, but there can be a demand for housing in Mayfield, KY, for example, where an institution in that market may need funds from a Home Loan Bank to make home loans.

Mr. McCANDLESS. One more quick one, Mr. Chairman.

You talked about the cyclical aspect of housing, which coming from California, I couldn't agree with you more. Where will the Federal Home Loan Bank System in your mind be 2 years from now, given the play out of the conditions and impacts that you are talking about?

Mr. SHOWFETY. My opinion is we will be a smaller system. We expect to see some continued shrinkage in our district. We have had a reduction of advances in the fourth district of about 30 percent. We would anticipate that we would probably have another 10 to 15 percent reduction.

The real key is going to be, and again, and I keep harping on this, the real key will be our success in bringing in new customers. If we are successful in that regard, we can obviously offset some of the shrinkage that is taking place in the thrift industry.

Mr. McCANDLESS. Would that be the position that the other two members take?

Mr. DITTENHAFFER. That is right.

Mr. THIEMANN. That is right.

Mr. McCANDLESS. Thank you, Mr. Chairman.

Chairman HUBBARD. Thank you, Congressman.

Congressman Floyd Flake.

Mr. FLAKE. In your testimony, it's obvious that we are looking at shrinking membership base, a soft real estate market, and you used the words "dark cloud." We didn't.

The question I would like to ask is, what do you need from this Congress in order for the Federal Home Loan Bank System to be able to be in the best position to attract new membership, if that is the vehicle you see for potential growth?

Mr. SHOWFETY. As Chuck pointed out earlier, I think that the number one concern we have is somehow reassuring commercial banks, our existing customers, stockholders, that their stock is sacred in the bank. If somehow or another we can remove that concern, that in my view would be number one.

Number two I think would be to make membership in the bank system more attractive by making the stock requirements more reasonable for institutions that do not meet the QTL test.

Mr. FLAKE. I yield to Mr. Barnard.

Mr. BARNARD. What is the difference between the ownership of stock in the Federal Home Loan Banks and the ownership of stock in the Federal Reserve System? Can you confiscate stock in the Federal Reserve System?

Mr. SHOWFETY. Not that I am aware of, sir.

Mr. BARNARD. What makes your stock different, then? Is it in the law that it cannot be confiscated?

Mr. SHOWFETY. There are probably some legal opinions that suggest otherwise, but not being a lawyer, I cannot comment on that.

I personally don't think it could happen, but stranger things have happened, I guess you would admit, in the past.

Mr. BARNARD. Well, I don't want to take up the gentleman's time, but is there anything in the Federal Reserve Act which is different in the Federal Home Loan Bank Act which ensures that their stock is not going to be confiscated?

Mr. SHOWFETY. I am not aware of it. I doubt that.

Mr. THIEMANN. I don't think there is, but what people are looking at, Congressman, is the fact that in FIRREA and in legislation prior to that, legislation confiscated all of the retained earnings to the Home Loan Banks, and so there is that kind of precedence.

It's not a one-for-one transfer, but people look at that experience and say, look, Congress confiscated your retained earnings, they may come back and take the stock.

Mr. SHOWFETY. The point is, too, we don't have a cushion. We don't have any retained earnings. If you determine that additional financial obligations were to be imposed upon the banks and they have no retained earnings with which to meet those obligations, then it dips into income or paid-in capital.

Mr. FLAKE. You are asking in essence the Congress to do something for you for the Federal Home Loan Bank System that it has not done for any of the other insurers, and that is to basically give

you a guarantee that there will be no requirement that your capital will not be confiscated. Is that what I am hearing?

Mr. SHOWFETY. That would certainly be helpful. You have done other things to us you haven't done to other systems, too.

Mr. FLAKE. Mr. Dittenhafer.

Mr. DITTENHAFFER. Congressman, I think there is one other thing, and maybe it's the way the Congress could send a signal that you are concerned about the Federal Home Loan Banks and our continued viability.

As has been mentioned several times, our contributions under the FIRREA are fixed in dollar terms, \$300 million per year to the Resolution Funding Corporation. That number is an arbitrary number which basically was 20 percent of our net income for the year 1988. I have argued, as have several of my colleagues, including Chuck, that our obligation should be a percentage of our net income, not a fixed amount.

I doubt whether our income in 1990 will be a billion \$500 million, which means that the \$300 million confiscation is going to be a greater than 20 percent tax rate.

Mr. FLAKE. Does FIRREA set that?

Mr. DITTENHAFFER. FIRREA set the \$300 million. If we set a 20 percent tax rate to fund the REFCORP bonds as we go forward, I think that might send a very strong signal to people that the Congress is concerned about the continued financial health of the Federal Home Loan Bank System, and that would be a very positive signal to the markets.

Mr. FLAKE. Now, how would that affect the stability of the bonds?

Mr. DITTENHAFFER. The interest on the bonds that have been issued by the Resolution Funding Corporation have several mechanisms for payment. The first \$300 million comes from the Federal Home Loan Banks. That is the \$300 million per year that we put in.

Behind that stands the funds going into the former FSLIC, and behind that stands the full faith and credit of the U.S. Treasury.

The interest will be paid. I think long term, if you look over the full 40 years that those bonds will be outstanding, probably 20 percent of our net income will amount to more than \$300 million per year.

But right now, I feel as though the Federal Home Loan Bank System is moving through a valley. We have to make this very, very arduous transition, and that \$300 million fixed obligation, plus the fixed obligation of the affordable housing program is a very great burden at this time.

If both obligations were couched as a percent of our net income, rather than as fixed dollar amounts, not only does that send a strong signal to the financial markets and the financial community that the Congress is concerned about our health, but it also means that we will be healthier, in fact, because less will be taken during these early years when it's most difficult to pay.

Mr. FLAKE. My time has expired, Mr. Chairman. Thank you.

Chairman HUBBARD. Thank you, Congressman Flake.

Mr. Thiemann, a number of thrifts taken into conservatorship by the RTC have subsequently been acquired by commercial banks,

few of which are members of the Federal Home Loan Bank System. What happens to the outstanding advances when such thrifts are acquired by nonmember banks or bank holding companies? Have any problems surfaced as a result of these acquisitions?

Mr. THIEMANN. No, Congressman. What has happened is that in cases where a commercial bank acquires a failed thrift and merges the failed thrift into the bank, that stock is redeemed immediately and those advances must be paid off immediately.

So all that is taken care of in the beginning. What happens on occasion, however, is that a commercial bank will acquire a failed thrift but hold it as a thrift in a holding company arrangement. And if it's held as a separate institution, as a separate thrift, then the stock holdings remain and the advances remain.

Chairman HUBBARD. Any additional comments on that question by Mr. Showfety or Mr. Dittenhafer?

As you know, the Federal Home Loan Bank System was founded back in 1932, a time when almost all home mortgages were issued by savings and loans. Well, almost 60 years later, savings and loans no longer dominate the home mortgage market.

Today, as we know, they compete both with commercial banks and mortgage bankers. My question is this: Do you see any reason why mortgage bankers should not qualify for Federal Home Loan Bank membership, and do you think they would find membership attractive?

Mr. SHOWFETY. I certainly see no reason, if they are engaged in residential mortgage finance. From my view they ought to have access to the same credit window that other residential lenders have access to.

Chairman HUBBARD. Mr. Dittenhafer.

Mr. DITTENHAFFER. I would agree with that. I might be a trifle more cautious and say that those mortgage bankers who are regulated as they are in some states or are part of regulated financial institutions, that might be a better first step for us.

We have traditionally been lenders to regulated financial institutions, and to open it entirely to mortgage bankers, some of whom are regulated, some of whom are not, I would have to personally be a little cautious about that.

Chairman HUBBARD. Mr. Thiemann.

Mr. THIEMANN. I agree. The emphasis has always been on institutions that were regulated and also institutions for the most part that were insured.

Chairman HUBBARD. Let me quote a commercial banker taken from a recent issue of the *American Banker*. He said, quote *American Banker*, "Home Loan Banks clear checks, handle, safekeeping, loan money and provide other services; however, those of us who belong to the Federal Reserve System are accustomed to dealing with it. All these same services are available from the Fed. I wonder if we really need two systems?"

How about some comments on that statement from a banker quoted in the *American Banker* and perhaps explain to us how you hope to attract commercial banks that are already members of the Federal Reserve System?

For example, what can you offer that the Fed cannot, or is it fair to even compare the two systems?

Mr. THIEMANN. We are the only source of intermediate and long-term credit for housing.

Now, the Federal Reserve will lend to a member bank to adjust its reserve position. They will lend overnight. They may lend for a few days. They will not lend for 2 years or 5 years or 10 years, and that is the difference.

We are the only link that our members have with the capital markets, in effect. And we can provide them with long-term funds that they can turn around and use for housing finance.

The Federal Reserve will not do that, and so it's the difference between night and day.

Mr. SHOWFETY. No question about it. The Fed's outstanding loans at any point in time may be \$3, \$4, \$5 billion dollars. The Home Loan Banks at their peak were close to \$150 billion.

We are still around \$120 billion. So I don't think you can compare the credit operations, as Chuck suggested, between the Federal Reserve and the Home Loan Banks.

Mr. DITTENHAFFER. I will just have to agree with that. I once made the statement in the presence of the Philadelphia Federal Reserve Bank president that the Federal Home Loan Banks are in business to make loans; the Federal Reserve Banks are in business not to make loans. That is the essential difference of the two systems.

Mr. SHOWFETY. We have the economic incentive to make loans, too.

Chairman HUBBARD. Congressman Parris, you want to respond to that and ask questions?

Mr. PARRIS. Thank you, Mr. Chairman.

I would just make the observation, and I want to pick up where your questioning left off, the Federal Home Loan Bank System, a financial institution, must be chartered either by state or Federal law; is that correct?

Mr. SHOWFETY. That is correct.

Mr. PARRIS. And I would not think that that applies to most—perhaps to some, I don't know. But that is an interesting ramification of that question. I just had one basic question, Mr. Chairman, that I would like to pursue quickly.

When the administration sent their original draft bill up for FIRREA, it prohibited the acquisition of troubled savings and loans by Federally-insured commercial banks, as you may recall.

My amendment and others of this committee permitted that acquisition which finally became law, and the theory there was very simple, was to broaden the market so as to support the value of the savings and loan franchise and to the greatest extent possible, make it an attractive, marketable commodity on the part of any qualified acquirer.

Now, yesterday the Federal Housing Finance Board indicated that the first credit union joined your system, and there were now 16 commercial banks. Some 30 new members joined since FIRREA was adopted in 1989.

The FIRREA legislation expanded the membership eligibility to include credit unions and commercial banks. The Chairman's suggestion on mortgage bankers is an interesting sideline to that, but it doesn't have to be part of the law yet; maybe it never will be.

My question, and perhaps it should be, I am not trying to take a position in that regard; it's just not there now. My question is, would you gentlemen care to characterize for us whether or not that is the satisfactory level of expansion to the system? Is it disappointing to you? Are you happy about the growth level, the increase in membership, or is that less than what you had hoped for?

Mr. THIEMANN. Well, I think given FIRREA and given what the commercial banks knew about the Federal Home Loan Bank System, upon the passage of FIRREA, it's not a bad record.

The learning curve is so steep, at the Cincinnati Bank we have marketed commercial banks for over a year now; and to be quite honest, they simply have many misconceptions about the Home Loan Bank System.

I mean, on the first visit, most of them will say that you are either a savings and loan or you are still a regulator, and you are going to impose an additional layer of regulations, so it takes a lot of time to explain what we are.

And number two, what we are not——

Mr. PARRIS. Excuse me. Could I just interrupt there?

We all have heard, and I won't get off on this, because how you do this in 3 minutes, but the quote, artificial credit crunch, that exists out there and the depression that is occurring in the construction and development industries, and the inability of banks, for whatever reason, including rating of their stock investment portfolios, and actions differing, reserve requirements imposed by regulations, or for whatever reason, there is a recognized artificial inability to acquire credit extensions for real estate transactions these days.

Now, is part of the reason that the banks don't go to you guys is because if they do, then they will become characterized in the opinions of some as development banks, which is a dirty word these days? Is that part of it?

Mr. DITTENHAFFER. Congressman, I have had conversations with a number of bankers about this, and I think the artificial credit crunch that you are talking about and that Congressman McCandless mentioned at the outset of his remarks, is supported by anecdotal evidence.

Mr. PARRIS. I have stacks of letters, if you would care to read them.

Mr. DITTENHAFFER. I have heard a lot of stories about it, but I have also heard stories about it from the institutions who are already members of my bank and who can borrow from us.

I think this is more of a regulatory reaction, an induced crunch rather than an access crunch. Maybe if these banks had access, they would be more encouraged. But I have heard from both members and nonmembers that the zeal of the examiners on some of these loans is what is prohibiting them from making new loans.

Mr. PARRIS. Just don't replicate the savings and loan problem, is what we are saying. Just, for instance, it seems to me a review of the new commercial bank members in the system represent fairly small institutions; 43 million, 42, 351, 93, 34, 44. Here's 4.4 billion, the Continental Bank in Norristown, PA. That is a pretty good-sized institution, 78 million, and so forth. They seem to be fairly

small banks that are interested in the services which your system offers.

Do you see any change in that? Is this a small bank service, big bank type problem? There is only one—I am sorry. There is Salt Lake City Bank at 2.6 billion.

But still, in relative terms, those are fairly modest-sized institutions.

Mr. SHOWFETY. The attraction is most likely going to be to the community-type banks. And to emphasize a point that I made earlier, Congressman Parris, I understand the average QTL ratio for those institutions which have joined at this point and those which have applied is right at 50 percent, making the point again that I don't think you are going to find institutions with the lower level of qualifying assets interested in bank membership under current stock requirements.

Mr. PARRIS. Well, you said something, Mr. Showfety, and you supervise and service my part of the world, the State of Virginia, as you know. And we have talked before. When you said that your extensions are held by one-third, I think you said one-third of the institutions do not meet the capital asset requirements of the FIRREA.

Mr. SHOWFETY. That is correct.

Mr. PARRIS. Isn't that going to give you considerable heartburn?

Mr. SHOWFETY. It already has.

Mr. PARRIS. You might get just downright indigestion.

Mr. SHOWFETY. Well, if I may make one other point, actually responding to a question that Congressman Flake had asked about required legislative changes. With the new QTL requirement going into effect as of July 1991 going from 60 to 70—we have got 86 institutions that will not meet those requirements. And those 86 institutions hold one-third of our outstanding advances.

Mr. PARRIS. So two-thirds of your member institutions will have some technical failure to meet the requirements of FIRREA by this time next year.

Mr. SHOWFETY. We are talking about a third of one number, and then we are talking about a third of that smaller number. So it's actually less than two-thirds.

Mr. PARRIS. So it's roughly, perhaps, 10 percent of your membership; is that correct?

Mr. SHOWFETY. Total outstanding advances are probably more like 40 to 45 percent, when you talk about the third. We start out with a third. We have about \$14 billion in outstanding advances, about a third of those, or let's say \$3.5 billion, which leaves us a balance of \$9-\$10 billion; and then another third of those.

Mr. PARRIS. You are counting money instead of institutions?

Mr. SHOWFETY. Yes, sir. I am talking about outstanding loans to these institutions.

Mr. PARRIS. Just one last question, Gentlemen. Are you continuing to pay dividends to the member banks? We hear a lot from thrifts who hold your stock, that they don't get the dividends that really impacts on their earnings per share, and other considerations of capital.

You are still paying dividends, I gather, and intend to do so. Is that fair?

Mr. SHOWFETY. Dividends this year systemwide, Congressman, are down about 20 percent thus far for the year.

That is on a systemwide basis. From bank to bank, of course, there are variations.

Mr. PARRIS. Do you see any dramatic change in that any time in the foreseeable future?

Mr. SHOWFETY. Speaking for the Atlanta Bank, we have averaged in the 10 percent range the last couple of years. We are averaging of a little less than 9 percent this year, and we are looking at something, say, around 8½ percent for next year if our projections hold true.

Mr. PARRIS. Unless some dramatic change in circumstance, your circumstances will not exacerbate the capital cash flow anticipations of member thrifts; is that right?

Mr. SHOWFETY. No, sir. I mean, obviously, as pointed out earlier, even though our dividends are holding up at an acceptable level, our income in dollars is shrinking. And as our income—the dollars—shrinks, then that fixed commitment of \$700 million a year—

Mr. PARRIS. It goes up in proportion to the amount of money available for the distribution of dividends?

Mr. SHOWFETY. That is correct.

Mr. DITTENHAFFER. May I expand on an answer that Bob gave you?

Mr. PARRIS. With the Chairman's permission, you go right ahead.

Mr. DITTENHAFFER. He mentioned very appropriately the fact that there are an awful lot of member institutions, that is traditional thrift members who will fail that QTL test in 1991, and that is true.

I think we need to fix that legislatively so that these significant home finance institutions can continue to have access to the Federal Home Loan Banks.

As I understand the law, at this moment, as of July 1, 1991, those SAIF insured institutions that fail a Qualified Thrift Lender test will be unable to borrow from a Federal Home Loan Bank.

Mr. PARRIS. And they have to shrink in size and stop growth?

Mr. DITTENHAFFER. You can have an institution that has half of its assets in home mortgages that would fail the QTL test in 1991. This is a significant home finance institution that would not be able to borrow from a Federal Home Loan Bank in order to finance new home mortgages.

And that doesn't seem to be consistent with our mission in home finance.

Mr. PARRIS. I agree with that.

Thank you very much. My time has expired.

Chairman HUBBARD. Congressman Barnard.

Mr. BARNARD. Mr. Dittenhafer, a while ago you recited what would happen as the earnings of the Federal Home Loan Banks declined and how interest payments would be met for the REFCORP bonds.

I understood you to say that if the economy is on the present level, now there are 582 million now, right, earnings for the system as of August 1990? Was that for 1 month, or was that—the schedule, Attachment One in your testimony—

Mr. DITTENHAFFER. The year to date, yes, I would have to look at the specific number.

Mr. SHOWFETY. It's about a billion dollars for the first 8 months, net income.

Mr. BARNARD. I am looking at an August 19—I couldn't determine whether or not you were talking about a year's change?

Mr. DITTENHAFFER. I am talking about a year's change. I am thinking about projections at an annual rate.

When FIRREA was conceived, the last full year—

Mr. BARNARD. Well, let me ask, do you see the possibility that the earnings of Federal Home Loan Banks would not be sufficient to make that \$300 million a year payment?

Mr. DITTENHAFFER. No, sir, I don't see that possibility. What I see is whatever earnings we have, if we only earn \$300 million, that has to go to the Resolution Funding Corporation, right off the top.

Mr. BARNARD. But you don't see any—I was looking at the August 19, 1990 \$582 million retained earnings figure, and it just—it seemed reasonable to me that it's not going to be for long before you would exhaust that figure.

Mr. DITTENHAFFER. Well, I can tell you that the—I am also Chairman of the Resolution Funding Corporation, and we have already begun to access the banks for that remaining \$500 million because we are going to market for another \$5 billion to turn over to Resolution Trust Corporation.

So in effect, those retained earnings are now zero.

Mr. BARNARD. So in other words, this may be hypothetical, but what you said was that if you exhausted the earnings of the Federal Home Loan Banks, eventually it becomes a taxpayers bailout?

Mr. DITTENHAFFER. Well, the bonds have been issued with the interest guarantee by the U.S. Treasury.

Mr. BARNARD. So consequently, we may be one more time hoodwinking the public to think that they are not going to have some liability as far as the REFCORP bonds.

They know they are going to have the liability as far as the general obligation bonds that are being sold—that are being issued now, right?

Mr. DITTENHAFFER. Well, for the bonds that are being issued by REFCORP, the principal is guaranteed by the monies that the Federal Home Loan Banks are turning over, and the interest is paid for the first 300 million a year for the life of those bonds by the 300 million we are required to contribute.

So—

Mr. BARNARD. So your \$300 million is not just targeted to the REFCORP bonds; they are targeted to the full indebtedness?

Mr. DITTENHAFFER. It's just the REFCORP bonds.

Mr. BARNARD. Okay. So what I am saying, there is a possibility of being an added liability to the liability that presently exists?

Mr. DITTENHAFFER. That is true.

Mr. BARNARD. Okay. That worries me. It looks like to me we are in gradual quicksand with this whole problem. This problem is not behind us from what I can discern.

I am not optimistic that we are not going to be going back, even for the REFCORP bonds, as far as public—taxpayers financing this.

Mr. DITTENHAFFER. Congressman, I believe that those bonds under FIRREA already have full faith and credit for the interest, and the principal is guaranteed by what the banks are contributing.

Mr. BARNARD. And the REFCORP bonds do, too. It's just like we pledge full faith and credit behind the FDIC and the FSLIC. No one ever thought it would come to the point that we would ever have to support it, but you see we are having to do that.

So I wouldn't want us to get in a false confidence that we are not going to still have some responsibilities there.

How do you feel? Do you think that FIRREA needs to be addressed next year?

Mr. DITTENHAFFER. I don't know about the whole bill, Congressman, but I would certainly hope that the problems we have indicated here today would be addressed in some form of legislation in the near future.

Just to add a little bit of clarity to what I said earlier about the \$300 million and the 20 percent, that \$300 million assessment comes off the top. If we make \$600 million, net income, that amounts to a 50 percent tax rate on our earnings.

I don't think anybody ever intended that to happen. But in good conscience, I could forecast a few years from now that we might be at net income levels which turn a \$300 million obligation to REFCORP into a 40 or 50 percent tax rate.

Mr. BARNARD. What is it now?

Mr. DITTENHAFFER. This year it will probably be about 27 percent. We have a fixed obligation of \$375 million, and our income will probably come in something less than \$1.5 billion.

So it's going to exceed the 20 percent; it's going to exceed 25 percent. It's probably going to be about 27 percent, would be my guess-timate.

Mr. BARNARD. Has the fact that FIRREA took away from the Federal Home Loan Banks and placed it in the OTS, all supervision, examination and so forth, has that affected your operations and your earnings to any degree?

Mr. SHOWFETY. Well, we no longer have the expense of the regulatory function which the banks were subsidizing. And as I recall, the number was somewhere between \$150 and \$200 million that was being picked up by the banks before the split, the rest being received from fees that were charged to the institutions that were examined.

So from that standpoint, it has reduced the expense burden on the banks.

Mr. BARNARD. So at the time that the old Federal Home Loan Bank Board transferred that operation to the regional banks, they did not pick up the cost; you picked up the total cost?

Mr. SHOWFETY. We picked up the total cost for the entire Federal Home Loan Bank Board, Congressman Barnard, by assessments for as long as I can remember, I guess since the system was created.

Mr. BARNARD. So that has been a savings, the new FIRREA organization has been a savings as far as that is concerned.

Mr. SHOWFETY. Yes, sir.

Chairman HUBBARD. Congressman McCandless.

Mr. McCANDLESS. Thank you.

In recent months, the credit unions have become virtually paranoid over what the future might hold for them, and I bring this up today because of the fact that credit unions have been a part of our discussion, one having joined recently.

They enjoy a nonprofit, no tax status. If I understand correctly, this one credit union will meet the QTL and therefore be able to join the system, or am I misled here?

Mr. SHOWFETY. No. I think only one has joined thus far. Now, there are a number of credit unions, and I am sorry, I don't recall the number. I think in this district, there are about a thousand credit unions that meet the 10 percent test.

Mr. McCANDLESS. Okay.

Mr. FLAKE. If the gentleman would yield.

Mr. McCANDLESS. Yes.

Mr. FLAKE. Just a follow-up question, and that is, as credit unions began to embark more and more in terms of housing loans and so forth and probably will reach that point where they cannot depend exclusively on the co-op, so to speak, or the monies that are coming from the shareholders, is this a viable potential market for increasing the membership base for the Federal Home Loan Bank Board, or are they too small to really make a difference?

Mr. SHOWFETY. There are many small credit unions in the country, and I guess it depends on the extent that credit unions get involved in mortgage lending.

I know in a conversation I had with Admiral Hughes earlier, and I am sure perhaps he will allude to it, they are getting different signals as to whether or not this is a direction the credit unions should move in.

So having said that, I won't comment on that any further, but I guess it really boils down to the extent that they get into mortgage lending. And there are some that are now. We have met and called on some large credit unions in this district. We had one tell us it was like trying to sell refrigerators to Eskimos, that we shouldn't be wasting our time. But generally, I think the appeal of the other correspondent banking services is probably more attractive to credit unions than the credit window. There is some potential there; I don't know how great it is.

Mr. FLAKE. Thank you, Congressman McCandless.

Mr. McCANDLESS. The other question I have deals with the line becoming more and more blurred in our financial institutions between those of commercial banks and savings and loans, and the fact that you still have savings banks and other types of names which virtually offer the same level of service that financial institutions do.

Do you gentlemen, from your vantage point of view, see one financial institution in the future with, say, a menu of permitted activities, depending upon what the administrative body of that institution feels is its expertise, and what it wishes to specialize in, as well as offering basic services to their customers?

Mr. THIEMANN. Well, I think, Congressman, one can make the case that over time, the two industries are moving together, certainly in a power sense they are. However, I would think that even if all had the same charter, you still would find institutions specializing, for example, in housing finance.

Our members, our thrift members are housing finance lenders. There are no two ways about it. That is what they do best. And if you look at those institutions who were not troubled and did not have problems, those were the institutions that stuck to their knitting, and did home loans, did not do all kinds of other crazy investments.

And I think you can make a strong case that the industry as a specialized industry is still viable today and makes a heck of a contribution.

Still today, nearly 50 percent of the home mortgages in the country, whether they be mortgages or mortgage-backed securities, are still held by thrift institutions. I mean, they still have that share of the market.

Mr. McCANDLESS. I guess when you look at the top five mortgage lenders in California, two of them stand out as banking institutions, and so the idea of the savings and loan and its concept to be able to offer single family mortgages has kind of reached a point and is fading off into the sunset, it would appear, from availability of money for that purpose from other sources that wasn't available in the 1930s and 1940s.

Mr. THIEMANN. That is true. But lots of times, you know, we do look at California and talk about the huge institutions in California that kind of dominate.

In the Fifth District, which is Ohio, Kentucky and Tennessee, our district, 60 percent of our members are a hundred million dollars or less in assets, and they tend to serve the housing needs of their local communities and those needs are not served by anybody else.

And they also are willing to make fixed rate mortgages, and they are able to do that because they can borrow from us and make fixed rate mortgages.

Mr. McCANDLESS. Are the majority of them going to be able to make the new tangible capital standards?

Mr. THIEMANN. In our district, almost everyone will. Clearly, we do come from a very conservative part of the country.

Mr. McCANDLESS. Thank you very much.

Thank you, Mr. Chairman.

Chairman HUBBARD. Thank you, Congressman McCandless.

Congressman Floyd Flake? Before you ask your questions, let me indicate it is our strong desire to end this panel by 3:45. The first witness of panel two has to catch a plane back to the State of Washington and needs to leave here by 4.

Mr. FLAKE. That is a long trip.

Chairman HUBBARD. We have got time for your questions. I wanted to give the news to Gerry Pittenger out there, we haven't forgotten him.

Mr. FLAKE. Thank you very much, Mr. Chairman.

One question: The \$300 million—the \$3 billion that you pay is offset in part by whatever you are saving and not having to do your own supervision. What was the cost of your supervision when you were assuming responsibility for it?

Mr. DITTENHAFFER. Congressman—I speak for New York, I think the numbers would be representative of the system. It cost us about 10 percent of our net income to do that. I think at least con-

ceptually that is where the numbers on the affordable housing program came from.

The feeling was we were no longer going to be responsible for funding that supervision function, then we could just as constructively put that money into the affordable housing program. That is my understanding how those two numbers came about.

The 3 billion came out of our retained earnings.

Mr. SHOWFETY. Congressman Flake, that number system-wide was about \$185 million last year.

Mr. FLAKE. So, it really had no major impact in terms of savings, then, in comparison to the 3 billion. What I was trying to determine, whether out of that \$3 billion there was a significant offsetting in terms of what you were paying for supervisory cost, but that would not be the case at all.

Then you turned that money back in to housing, essentially, to do community programs.

Mr. SHOWFETY. That is correct.

Mr. FLAKE. Thank you, Mr. Chairman, I yield back the balance of my time.

You have intimidated me successfully.

Chairman HUBBARD. One of my favorite people around here, Floyd Flake. I wasn't trying to intimidate anybody. We have taken this subcommittee to his district, incidentally.

Let me ask you this: FIRREA created the Federal Housing Finance Board—they oversee you all. Do you ever see them?

Mr. THIEMANN. Yes, we do, Mr. Chairman, but as of the moment, the only member of the Federal Housing Finance Board is the Secretary of HUD, Mr. Kemp. The other four have not—have not been appointed in the sense there have been no hearings—no confirmation hearings.

Chairman HUBBARD. Maybe that is why we are having trouble trying to get one of them to be a witness for a hearing. We tried—we do know their names, do we not?

Mr. THIEMANN. Four members have been nominated.

Chairman HUBBARD. There has been a dispute between the administration and certain Congressmen over the terms, whether they are permanent or temporary?

Mr. THIEMANN. It apparently is a dispute over whether they are full-time or part-time.

Chairman HUBBARD. This was not spelled out in FIRREA?

Mr. THIEMANN. Apparently, it was if you had enough people feel they can make a case that it is full-time, and others that it is part-time. There was no specific language, I don't believe.

Chairman HUBBARD. It is interesting we created FIRREA and they are supposed to oversee you all.

Mr. BARNARD. It works out better.

Mr. DITTENHAFFER. We have no comment on Congressman Barnard's comment.

Chairman HUBBARD. Congressman Barnard added, we have got too much oversight now. Anyway, now we know why we have trouble getting a witness from the Federal Housing Finance Board for our hearings, last year and this year. Hopefully, next year we can have the Federal Housing Finance Board to provide us a witness.

Thank you, gentlemen. We appreciate your testimony and answering our questions.

Mr. THIEMANN. Mr. Chairman, we do appreciate this opportunity, and we would like permission to expand on some of our answers for the record and submit additional materials that we think would be of benefit to the committee.

Chairman HUBBARD. Thank you very much. Come to think of it, members of the committee will probably want to ask additional—

Mr. BARNARD. What he is saying is, we didn't have very penetrating questions.

Chairman HUBBARD. Our second panel consists of Gerry J. Pittenger, Chairman, President and CEO, Great Western Bank, Bellevue, WA; Edward L. Yingling, Executive Director, Government Relations, American Bankers Association, Washington, DC; Sheldon L. Pollock, Chairman of the Board, North American Bank & Trust Company, Waterbury, CT; Vice Admiral Thomas J. Hughes, USN Retired, Treasurer, National Association of Federal Credit Unions, and President and CEO, Navy Federal Credit Union, Vienna, VA; and Robert S. Duncan, Chairman and CEO, Magnolia Federal Bank for Savings, Hattiesburg, MS.

I would ask unanimous consent that the opening statement provided our subcommittee by the Honorable Chalmers Wylie, ranking member of the full Banking Committee be included in our record of today. Without objection, so ordered.

[The prepared statement of Mr. Wylie can be found in the appendix.]

Chairman HUBBARD. Gerry Pittenger, we are giving you first chance here. You are here from Bellevue, WA, representing the National Council of Savings Institutions. Again, this man is President, Chairman, CEO of Great Western Bank, Bellevue, WA.

STATEMENT OF GERRY J. PITTENGER, CHAIRMAN, PRESIDENT AND CEO, GREAT WESTERN BANK, BELLEVUE, WA

Mr. PITTENGER. Thank you, Mr. Chairman.

Mr. Chairman, on behalf of the National Council of Savings Institutions, I would like to thank you for the opportunity to appear before you today to present our concerns and answer your questions over the status and future direction of the Federal Home Loan Bank System.

My name is Gerald J. Pittenger, and I am Chairman, President and Chief Executive Officer of Great Western Bank, a savings bank, in Bellevue, WA. In addition, I am a member of the Executive Committee of the National Council of Savings Institutions, a former Director of the FHLB of Seattle, and currently unopposed for a new term at that bank.

As a means of developing our positions and policies on the future of the system, the National Council has established a task force to study the matter and make major policy and structural recommendations.

The work of the task force, of which I am the chairman, not only will include industry input but will also seek input from the bank presidents and their Boards of Directors. Our report should be com-

pleted early next year, and we will be happy to send a copy of the final report to you, Mr. Chairman.

Before I begin my remarks, I would like to state that the National Council places tremendous importance on the future health of the Federal Home Loan Bank System. Our industry's stock investment in the system is over \$11 billion, an amount that represents about 25 percent of the industry's capital base.

Our continued investment in a healthy system could be instrumental in obtaining our mutual goals: Reducing the cost to the taxpayers of resolving the insolvent savings institutions, helping to maintain the capital position of marginally solvent institutions, and insuring the long-term viability of the system as a valuable tool in meeting the housing needs of this country.

While I go into these matters in greater detail in my written statement, I would like to briefly address the two biggest problems caused by FIRREA.

First, the significant fixed costs to the system will assume an increasing share of a shrinking earnings base. If the system continues to shrink, at some further date this fixed burden may become unsupportable.

Second, the erosion of the system's capital base due to FIRREA's taking of retained earnings has already reduced the system's earning capacity and may, if it continues, threaten the viability of the system. While the system still has over \$11 billion in capital, this is significantly less than the \$16.2 billion in capital before the passage of FIRREA. Moreover, the costs imposed on the system are likely to continue the capital erosion.

While I don't want to take your time to reiterate all the provisions of FIRREA that affect the system, I think it safe to say that the net effect on the system was and will continue to be decidedly negative.

These provisions have reduced the size of the system, cut profitability and the dividend stream, and eroded the capitalization of the system. Let me be more specific. As of this July:

The total assets of the systems have dropped from \$194 billion to \$160 billion, a drop of 17 percent; advances in the system have dropped from \$160 billion to \$123 billion, a drop of 23 percent; income of the system is over 24 percent lower, even though significant non-recurring pre-payment income was generated by the pay-down of advances, largely by the RTC; finally, the capital of the system has declined from over \$16 billion to just over \$11 billion, a drop of almost 28 percent. The capital-to-asset ratio has fallen from 8.4 percent before FIRREA to 7.3 percent today.

The drop in advances is extremely troubling because advances are the primary vehicle used by the Federal Home Loan Banks to support housing finance, and they are the primary product and income producer of the banks.

If advances continues to decline, the ability of the system to generate earnings will be eroded and the ability of the system to contribute to clean-up costs and affordable housing may be impaired.

Currently, a disproportionately large amount of advances are outstanding with insolvent or weakly capitalized institutions. As these institutions are resolved, advances will decline. If the system

is to survive, either other sources of revenue must be found or the heavy burden placed on the system by FIRREA must be reduced.

Obviously, you recognized the importance of this issue when you specifically asked us to report to you on the Federal Home Loan Bank's ability to attract new members.

A limited number of new institutions have been admitted to the system, and a few more applications are currently pending at the Federal Housing Finance Board. As time passes, prospective members will be better able to assess the viability of the system and the benefits from membership. In assessing whether or not to join the system, potential investors must satisfy themselves as to:

One, the safety of the investment; two, the cost of borrowing; three, the future earnings potential and dividend stream, which, if further decreased, could make borrowing uneconomical; and, four, future legislative or regulatory changes that could freeze them into an unsound investment.

If the Congress were to take action that reduces the uncertainty facing the system, including restructuring its fixed burdens under FIRREA, perhaps by restating them as a percentage of income, then the concerns of potential Federal Home Loan Bank members as to the viability of the system would be greatly reduced. Existing voluntary members would not be led to exit the system and new members would be encouraged to join.

Mr. Chairman, you also asked whether the number of Federal Home Loan Banks should be altered. If, in the future, a specific district were to see sufficient erosion in its membership to make it uneconomical to continue on as a separate bank, the system may have to be adjusted at that time.

However, many factors should be considered before this step is taken, such as geographic distribution of the member/stockholders; the future services to be performed by the system; and the public policy role for the Federal Home Loan Bank System as it relates to housing.

Mr. Chairman, one area in which the Congress might be of immediate help does not require legislation. The Federal Housing Finance Board was created to oversee the credit function of the FHLB system. This agency was supposed to have a five-person board comprised of the Secretary of Housing and Urban Development and four private citizens.

Unfortunately, none of the Presidential appointees have been confirmed. We are concerned that this has resulted in a lack of direction to the system.

In conclusion, the provisions of FIRREA have placed a heavy burden on the Federal Home Loan Bank System and in turn on the surviving savings institutions that are members of the system. We are skeptical that the inflow of new members will compensate fully for the loss in revenue.

In any event, the capital of the system will be eroded, and the longer-term viability of the system will be called into question. We urge the Congress, in any future legislation, to be very careful to avoid placing any additional burden on the Federal Home Loan Bank System.

Mr. Chairman, as the National Council concludes its study, we would be pleased to submit to you a copy of that study we hope will be helpful in the solution of keeping the system strong.

Thank you.

[The prepared statement of Mr. Pittenger can be found in the appendix.]

Chairman HUBBARD. Thank you very much for your testimony. When will the recommendations of your task force be available?

Mr. PITTENGER. We would like to have that completed by the latter part of January, first part of February.

Chairman HUBBARD. If membership were made voluntary for all members, would you have any objections to creating uniform stock purchase requirements for all members?

Mr. PITTENGER. I think if uniform stock purchase requirements are considered, making it voluntary should be a part of that.

Chairman HUBBARD. One last question. Will you oppose the creation of a single standardized QTL test for all members of the Federal Home Loan Bank System? For example, would you support requiring all members to hold at least 10 percent of their assets in home mortgages instead of the current system which mandates different QTL standards for thrifts and commercial banks?

Mr. PITTENGER. I think the whole area of the QTL test should be looked at as to existing members and perspective new members, and those terms ought to be equitable.

Chairman HUBBARD. Congressman Parris, questions for Mr. Pittenger.

Mr. PARRIS. I just have one question, Mr. Pittenger, and I think it is implicit in all of this, and I think it was mentioned earlier by someone—I forgot, perhaps Mr. Barnard or Mr. Hubbard, one of the two. Are we, or should we be going in the direction of an amalgamation of the industries here?

And I—please, Admiral Hughes, before you overreact to the credit union insurance fund being included in all that, I am not advocating that. My question really is, in the long term of all of this—and your name is not Jeane Dixon, and neither is mine, but over time—whether that is 10 years or 110 years, will we see—should we see in this Nation the amalgamation of delivery of financial services and credit extension opportunities for institutions—Federally-insured or not? The question of restructuring.

I think we simply have got to begin addressing that in this committee one of these days, and I keep getting what I think are ambivalent signals from various folks about whether or not that is good or bad, or undesirable or strengthening in terms of the industry itself.

I am not trying to penalize commercial banks versus S&Ls are otherwise, but the duplicative regulations we have with the obvious commercial competition that is represented in part by thrifts in the Federal Home Loan Bank System, and the OTS, and all the rest of it—I mean, you all know all about that, you are experts at it.

Where should we be going is really what I am asking.

Mr. PITTENGER. Obviously, I may be biased when I respond to your question, but I also have been involved in this industry for some 23 years, and I believe the thrift industry has done an out-

standing job in providing housing financing over that period of time to the American public.

And I have not only children, but grandchildren, and I am very concerned about their ability to have housing in the future, along with other young people in this country, and I think it has been very beneficial to have specialized lending institutions in the past, and I think we should go very slow in amalgamating them.

I think that even though we are faced with a horrendous problem today by some mistakes that have been made in the past, contributed by all sorts of reasons, never the less I think that it can be safely said that over the past 40, 50 years, that a specialized housing lending system has done an outstanding job in providing housing for the homeowners of this country, and I think if there is anything that contributes to our society, it is homeowners.

If you own it, you take care of it, and if the opportunity there eventually is to own something, it holds out some very high hope for you in the future that you will have your dream come true.

So, I would be very slow to consolidate all of the lending systems. And also, it has been my experience in the past, there are times when, whether it is leveraged buyouts or whether it is loans to foreign countries, or what it is, there are markets that oftentimes will pay up for money higher than home financing is able to afford at that point in time.

If you have a specialized industry that has identified with that and they make their primary income off of it, they will take care of the folks a lot better than the alternative that will pay a higher rate at that particular point in time.

Mr. PARRIS. I don't disagree with your comments at all, Mr. Pittenger. The only response I have to them is, doesn't that emphasize what you will hear from Mr. Yingling and others, that that is a justification, if you will, for the increased involvement of commercial banks in mortgage lending activities, and credit unions going more into mortgage lending to greatly enhance the American Dream?

Why these somewhat typical governmental restrictions on what commercial banks can do? Why not just open the door?

Mr. PITTINGER. Well, I would like to see over time folks that may be dedicated to providing financing for housing today will be there during the long term. I think that economic events make it more practical, or maybe there have been some legislative or regulatory changes that enhances the benefit of holding those assets.

But I think the test of time will be the more important one to see who sticks with providing home financing. The thrift industry has dedicated itself to that over time. I believe there have been community banks that have done a reasonable job in that area through the years, and I don't take anything away from them, but I do believe that it does come down to the point that if they have alternatives of where the money can go in other directions at a better return, at some point in time in the future they may not be there.

Chairman HUBBARD. Congressman Barnard.

Mr. BARNARD. Mr. Pittenger, do you think that the circumstances that have transpired since August 9th, 1989, and the passage of FIRREA are such that it would justify a reconsideration of FIRREA next year?

Mr. PITTINGER. I think as it relates to the topics that we have discussed here affecting the Federal Home Loan Bank, I certainly think it would be important to revisit it.

Mr. BARNARD. Are there any other subjects you think would be of concern that we should be addressing?

Mr. PITTINGER. I am sure there are.

Mr. BARNARD. What about the QTL test?

Mr. PITTINGER. I think definitely, that needs to be readdressed. It is set at a level that is not practical if you are in a housing market, where housing loans are not plentiful. I think very definitely, that needs to be readdressed.

Mr. BARNARD. I have no further questions.

Chairman HUBBARD. Congressman McCandless.

Mr. MCCANDLESS. Mr. Chairman, did we say he was going to catch a Seattle Special?

Mr. PITTINGER. Let me say this: This is more important to me than the plane, and I appreciate your concern over me, but if—I will answer any question, or stay.

Mr. MCCANDLESS. I would be happy to direct my questions to other members of the panel and permit him to catch the plane. I have a certain respect for cross-country traveling, and the fact they don't leave on the hour like some of my colleagues enjoy in New York and Connecticut.

I have a couple of questions for Admiral Hughes and maybe Mr. Pollock. Is this permitted, Mr. Chairman.

Chairman HUBBARD. Could you go ahead and ask Mr. Pittenger his questions, and then we will excuse him.

Mr. MCCANDLESS. Why don't I hold my questions?

Chairman HUBBARD. Any for Mr. Pittenger?

Mr. MCCANDLESS. No. I think the areas I was interested in have already been covered.

Chairman HUBBARD. We thank you very much, Mr. Pittenger, for being with us, and we want you to catch your flight.

Mr. MCCANDLESS. I hope you have an upgrade.

Chairman HUBBARD. Thank you for being with us.

Chairman HUBBARD. Now we will hear from our other witnesses. This, incidentally, is the final panel. Edward L. Yingling, Executive Director of Government Relations.

**STATEMENT OF EDWARD L. YINGLING, EXECUTIVE DIRECTOR,
GOVERNMENT RELATIONS, AMERICAN BANKERS ASSOCIATION,
WASHINGTON, DC**

Mr. YINGLING. Thank you, Mr. Chairman.

I do appreciate the opportunity to appear before the subcommittee to comment on behalf of the ABA on community bank participation in the Federal Home Loan Bank System.

The banking industry has a tremendous and growing interest in the mortgage markets. In fact, the U.S. commercial banking industry now extends more residential mortgage credit than any other industry, including the thrift industry. For this reason, the role of banks in the Federal Home Loan Bank System is critically important.

The issues you have identified, Mr. Chairman, bear directly on the structure and continued existence of the Federal Home Loan Bank System. It is important and timely that these issues be reviewed. The ABA commends you, Mr. Chairman, for holding this follow-up hearing.

As you know, FIRREA narrowed the focus of the Home Loan Bank System to provide a broader source of funding for residential mortgages. Membership in the system, previously restricted to only thrifts, was extended to allow banks and credit unions to join.

Unfortunately, the structure of the system has discouraged participation by banks. In fact, as of last week only 24 banks, now up to 40, have become members, out of an estimated 7,300 that qualify for membership. Clearly, the salutary goals envisioned in expanding Federal Home Loan Bank membership has not been met.

The following changes would result in greater participation by banks:

First, elimination of the minimum ratio of mortgages to assets necessary to qualify for membership. Current law requires a bank to have at least 10 percent of its total assets in residential mortgage loans. This requirement makes roughly 5,000 banks ineligible.

Second, elimination of the differential requirement between thrifts and banks for purchasing Federal Home Loan Bank stock. This stock ownership requirement, as a practical matter, limits bank participation to those banks who have a very high percentage of their assets in mortgages.

Third, elimination of the limit on the total amount of advances that can be issued to banks. In the long run, as the thrift industry shrinks, this limit will come into play.

Another factor inhibiting bank participation is concern over the ability of the Home Loan Banks to meet their obligations to help finance the S&L cleanup, yet at the same time, provide advances and pay dividends on stock at attractive rates.

Currently, as you know, the Home Loan Banks must make annual contributions to the Resolution Funding Corporation of \$300 million. In addition, the Home Loan Banks must collectively contribute to the affordable housing program a minimum sum of \$50 million. This minimum contribution increases to \$75 million in 1994 and \$100 million in 1995.

Meeting these obligations may become increasingly difficult if the Federal Home Loan Bank System continues to contract. Since FIRREA was signed into law last year, the advances held by the Home Loan Banks have declined 22 percent. Thus, the fixed obligations come out of a smaller pool of earning assets.

In addition, there is some fear that more of the capital or earnings of the Home Loan Banks will be tapped. All this certainly affects the projected returns on Federal Home Loan Bank stock, making membership less attractive to commercial banks.

Of course, eliminating unnecessary impediments to bank participation in the Federal Home Loan Bank System will likely improve the financial structure of the system, making it easier to meet the FIRREA obligations while making Federal Home Loan Bank stock an attractive investment.

Let me touch on a couple of other issues that need to be reviewed in the long run. The ABA would recommend that Congress take a

good look at the correspondent services that are provided by the Home Loan Banks. Questions which need to be answered include:

What should be the role of Home Loan Banks in providing correspondent services? How does this role affect the provision of correspondent services by private providers, including "bankers banks"? How do the costs of providing these services compare to costs of private providers? To what extent are these services provided by Federal Reserve banks?

One other issue that the ABA is concerned about is the extension of asset powers of Home Loan Banks beyond advances. Congressional review is needed as to what other assets, such as jumbo mortgage loans or interest-only and principle-only strips, should Home Loan Banks be allowed to hold.

These issues are part of the broader question of the role of the Federal Home Loan Bank System in our overall financial system. The massive changes taking place in the thrift industry, combined with the impact of FIRREA on the Home Loan Banks, have undermined the traditional role of the Federal Home Loan Bank System. The Congress, we believe, needs to take a careful look at what the role of the Home Loan Banks should be in the future.

You asked us, Mr. Chairman, to testify specifically on whether commercial banks are finding Federal Home Loan Bank membership an attractive option. The answer is generally no. As you have heard this afternoon, eliminating the arbitrary minimum level of mortgages-to-assets necessary for membership, the differential stock-purchase requirement, and the limit on advances to non-thrift lenders would go a long way to encourage banks to join the system, although there are other fundamental, longer-term questions which are also having a chilling impact.

Mr. Chairman, once again, you and the subcommittee are to be commended for your continuing oversight on this important issue. Thank you.

[The prepared statement of Mr. Yingling can be found in the appendix.]

Chairman HUBBARD. Thank you for your excellent testimony.

Now we will call on Sheldon L. Pollock, Chairman of the Board of the North American Bank & Trust Company of Waterbury, CT.

STATEMENT OF SHELDON L. POLLOCK, CHAIRMAN OF THE BOARD, NORTH AMERICAN BANK & TRUST COMPANY, WATERBURY, CT

Mr. POLLOCK. A personal note, perhaps if you indulge me, I am also accompanied by my son, who is a sophomore in high school and has tried to use the ploy of a sick grandmother to come down here. And I would like to introduce Shelly to you.

Chairman HUBBARD. His name, again?

Mr. POLLOCK. Sheldon Pollock III.

Chairman HUBBARD. Thank you for introducing us to Sheldon Pollock III.

Mr. POLLOCK. Mr. Chairman, my name is Sheldon Pollock, and I am Chairman of the Board and CEO of the North American Bank and Trust Company of Waterbury, CT. I am appearing today on behalf of the Independent Bankers Association of America, the

only national trade association that exclusively represents the interests of community financial institutions.

This is the second opportunity we have had to discuss the broader membership in the Federal Home Loan Banks provided for under the Financial Institutions Reform, Recovery, and Enforcement Act, FIRREA.

My testimony today will center around my bank's decision to join the Federal Home Loan Bank of Boston and the potential benefits of membership to community banks around the country.

A few years ago, the banks in New England were strained for liquidity and lendable funds. The choices available to commercial banks were to use the national brokered C.D. market or curtail lending. Yet, thrifts had a very appealing alternative. They were able to use the advance window at the Federal Home Loan Bank. They used this option extensively.

To obtain similar access to advances, our bank applied for membership in the Boston Bank. While our application was pending, we learned that Congress was considering opening membership to commercial banks.

As soon as FIRREA passed, we renewed our application and our bank was the first commercial bank member from New England. Our bank and other commercial bank members from New England have found Federal Home Loan Bank membership attractive.

The primary benefit of membership is the access it provides to reasonably-priced money through the advance window. We can re-lend those funds into our community for housing and jobs.

Not only will this benefit housing and home ownership, but it will also provide much-needed employment. This will help us meet our banks' responsibilities under the Community Reinvestment Act.

Since 1978, the Federal Home Loan Bank of Boston has offered programs for both affordable housing and community reinvestment, as have a number of other district banks. In New England, the affordable housing program is particularly attractive because of the high price of housing there. My judgment is that, in time, these programs will make a major impact in helping to provide more affordable housing stock in our Nation.

The Federal Home Loan Bank of Boston has aggressively sought members over the years, perhaps more so than the other district banks. Interest among commercial banks in our area is high.

My personal experience is that the Boston Bank does not impose a great deal of red tape and that the bank's staff is very gracious and helpful whenever any questions arise.

The Boston Bank's new members may not immediately boost demand for advances, however. We are in a recession in New England and many banks are trying to shrink. As our loan demand decreases, our funding requirements can be supplied by local depositors. Eventually, this will turn around.

Some bankers in other areas of the country have told me that they were reluctant to join the system as long as their deposits cost less than the comparable rate for advances. I have explained that the advances can provide an economical source of funds in times of high loan demand.

Surveys by the American Banker, as well as the IBAA, have indicated that commercial banks are becoming even more involved in home lending. We recognize this, and the IBAA is close to establishing a mortgage corporation which will seek to provide community banks with a consistent and reliable secondary mortgage outlet. Federal Home Loan Bank membership could provide a useful complement to this new IBAA service.

FIRREA's membership requirements for commercial banks has dampened commercial bank membership interest. Also, the system banks must conform to an overall limit that provides that non-QTL members, primarily commercial banks, cannot borrow more than 30 percent of the total advances.

I understand that changes in the stock purchase requirement and the lending limits are under consideration in Congress. If these changes make membership more attractive to commercial banks, it could benefit everyone concerned, including the Federal Home Loan Banks, their current members, as well as the commercial banks and their customers.

We continue to believe that Federal Home Loan Bank stock is a good investment, based on their strong financial performance.

Another question that we were asked to discuss was whether or not the number of district banks should be altered. While I am not an expert in this area, there is one observation that I would like to make. Whenever a bank makes loans in its own market area, loan losses are usually far less than when it lends outside of its normal trading areas.

I would judge the same to be true with respect to the Regional Federal Home Loan Banks. The Boston Federal Home Loan Bank has an excellent record of lending in its home area of New England.

From this testimony, you can see that we find membership attractive. Our dividend rate from the Boston Bank has been running between 9.25 percent and 10.42 percent. It is well-managed and financially sound.

We have access to attractive borrowing programs to help our community. We welcome the Federal Home Loan Banks' initiative in seeking to involve our banks in their programs. If they are successful, it will work to the benefit of all concerned.

Thank you very much.

[The prepared statement of Mr. Pollock can be found in the appendix.]

Chairman HUBBARD. Thank you very much, Sheldon Pollock. We appreciate your comments. We will have questions later, but it won't involve the World Series.

Mr. POLLOCK. Well, we know the Red Sox are going to win, notwithstanding Mr. McCandless' observation.

Mr. MCCANDLESS. Will you kindly leave your Social Security number? It looks to me like you need an audit of some type.

[Laughter.]

Chairman HUBBARD. Vice Admiral Thomas J. Hughes, U.S. Navy, Retired. He is the Treasurer of the National Association of Federal Credit Unions and President and CEO of the Navy Federal Credit Union, Vienna, VA.

Admiral Hughes.

STATEMENT OF VICE ADMIRAL THOMAS J. HUGHES, USN (RETIRED), TREASURER, NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS, AND PRESIDENT AND CEO, NAVY FEDERAL CREDIT UNION, VIENNA, VA

Admiral HUGHES. Thank you very much. I have submitted a written statement for the record, and subject to your approval, I would appreciate if it went in the record. I would now like to summarize orally key points.

Chairman HUBBARD. Without objection, your full written statement is entered into the record.

Admiral HUGHES. Thank you very much.

The National Association of Federal Credit Unions views the authority for credit unions to utilize Federal Home Loan Banks as an alternative source of liquidity for mortgage loans and as a potential benefit to credit unions. NAFCU has performed many forums over the last year to educate the members of our Association, credit union officials throughout the country, on the benefits and services available through the Federal Home Loan Banks.

I have had the privilege of exploring this option with Mr. Showfety of the Atlanta Federal Home Loan Bank, who preceded me here today. He gave us a very good dissertation on the things that are available to credit unions. On a personal basis, we at Navy Federal Credit Union, appreciate that very much.

As NAFCU, though, we do not advocate or discourage participation in the Federal Home Loan Banks. As far as NAFCU is concerned, that is a management decision for the credit unions to make. Our research indicates the Federal Home Loan Banks are operating soundly.

Our concerns, however, amount to three things: First, will they bear further taxation from the Congress, as was presented earlier—and you in your opening remarks addressed. Secondly, will State-chartered thrifts be able to exit at will? Thirdly, will the Federal Home Loan Banks continue to exist as they are presently conceived?

Given the experience of the last year, it does not appear that a significant number of credit unions will be joining the Federal Home Loan Banks in the near future.

To make the Federal Home Loan Bank more attractive to credit unions, the already-discussed stock purchase biases should be reduced. Withdrawal should be made easier from a time basis. And then, a very hidden thing, I think, in response to Mr. McCandless' introductory remarks: there is a tremendous dichotomy between the requirements of our regulator, the NCUA, in his guidelines and his examiner's direction on the maximum amount that credit unions can invest in long-term loans, to wit, mortgage loans, and the requirements for stock subscriptions in the Federal Home Loan Banks.

NCUA says you should not have more than 25 percent of your portfolio in mortgage loans. The goal of the Federal Home Loan Banks, of course, is just the opposite: to proliferate funds available for mortgage loans. That is a very basic philosophical dichotomy that should be, and I think can be addressed. NCUA's concern is interest rate risks and getting too involved over a long period of

time, whereas the Federal Home Loan Banks' concerns are different than that.

So, I think that should be addressed and cleared up between the regulators. The availability of the Federal Home Loan Bank funds, when liquidity is not a problem, is not very high on the credit union's priority list.

We don't have a liquidity problem, so we don't go around looking for it right now. And given the ceilings the NCUA puts out as guidelines, it doesn't make us a very good customer. I would be happy to answer questions later on, either as a table officer of the Trade Association, NAFCU, or as the President, CEO of the Navy Federal Credit Union.

Thank you very much, gentlemen.

[The prepared statement of Mr. Hughes can be found in the appendix.]

Chairman HUBBARD. Thank you, Admiral Hughes. Also, the one who accompanied you from NAFCU, John Zimmerman. We appreciate you and John Zimmerman being here.

Next is Robert S. Duncan, Chairman and CEO, Magnolia Federal Bank for Savings, Hattiesburg, MS, accompanied by Denis O'Toole.

**STATEMENT OF ROBERT S. DUNCAN, CHAIRMAN AND CEO,
MAGNOLIA FEDERAL BANK FOR SAVINGS, HATTIESBURG, MS**

Mr. DUNCAN. Thank you, Mr. Chairman, and members of the subcommittee.

My name is Robert Duncan. I am Chairman and Chief Executive Officer of Magnolia Federal Bank for Savings, an \$800 million healthy savings institution in Hattiesburg, MS. I am pleased to testify today representing the U.S. League of Savings Institutions.

The Federal Home Loan Bank System has been extremely low-risk and conservative during almost 60 years of existence. The 12 banks have never suffered a loss on a loan and are extremely well-capitalized when compared with other GSEs.

It is highly ironic that the first chinks appeared in the banks' impressive structure only after the government itself started to draw the bank system into the resolution process for failed and failing savings institutions.

The banks' retained earnings are being stripped away and, over the next 30 years, the bank system will be asked to contribute at least \$15 billion to FICO and REFCORP debt service and to affordable housing.

As a result of shrinking numbers of solvent thrifts and increased thrift capital requirements, the demand for Federal Home Loan Bank advances are declining. Still, the earning power of the banks relative to their capital structure has held up fairly well for now.

But what happens if the shrinkage of the system continues? The annual toll imposed on the banks by FIRREA is essentially a flat fee rather than a fee tied to income. As the income of the banks declines with the shrinkage in the banks' loans, the FIRREA assessments will amount to a greater percentage of the banks' net income.

We recommend that the tariffs for the Resolution Funding Corporation and for affordable housing be made a percentage of the banks' income rather than being flat fees.

Our other major concern is that our institutions are forced to belong to the bank system and to hold significant amounts of bank system stock. It is a matter of extreme concern that billions of dollars of the industry's net worth are tied up in this forced investment.

People in our industry fear that this capital will be subject to additional confiscation in connection with the ongoing attempt to clean up failed thrifts. Because of these new concerns, we now have the ironic circumstance that some members that are required to belong to the system are trying to leave, while those that are free to leave are choosing to stay.

Thus, in the past few months, we have had Wauwatosa Savings in Wisconsin, along with a few other institutions, arguing that, as State-chartered institutions, there is no legal requirement forcing them to remain as members of the Federal Home Loan Banks.

At the same time, 75 percent of the members in the Federal Home Loan Bank in Boston are voluntary, and there has not been a single defection since the passage of FIRREA.

This is totally logical. Voluntary members know that if they see any undue threat to their investment in the stock of the bank system, they will be able to redeem their stock and get out. With this escape hatch, these institutions are willing holders of the stock needed to gain access to the benefits that membership in the banks offer.

Compulsory members do not have that escape hatch and some have determined that the benefits of membership in the bank system do not compensate for the danger to their capital of being required to hold Federal Home Loan Bank stock. Because of these unusual characteristics of the Federal Home Loan Bank System, we urge that membership in the Federal Home Loan Bank System must be voluntary.

Some would argue that making the stock voluntary would threaten the stability of the bank system since institutions would then be free to leave, liquidating their stockholdings in the banks. The experience of the Boston and New York Bank Districts show that this is not so. The banks can and do retain voluntary members.

In fact, those who maintain that voluntary membership would destabilize the banks are implicitly saying that there is something so distasteful and dangerous in being a member of the bank system that the banks need the force of law to compel institutions to join. The Boston and New York experience shows that this is simply not true.

It is also imperative that the Federal Home Loan Bank System must continue to be operated with minimal risk.

Since savings institutions are presently captive stockholders of the banks with a large percentage of their net worth invested in bank stock, they cannot afford to lose their investment. The banks must continue to operate in the same conservative manner as they have in the past.

In recent months, there have been suggestions that the Federal Home Loan Banks find new areas of endeavor to help bolster their dividends. For instance, the Dallas Bank has suggested getting involved in loans to developers while the New York Bank floated the idea of investing in jumbo mortgage loans.

Since savings institutions own the banks' stock and, therefore, are recipients of the dividends the banks pay on that stock, they are vitally interested in having that dividend as high as possible. Even more important than the amount of the dividend, however, is the integrity of the stock itself.

If holding the stock were optional and a bank decided to engage in some risky activity, a particular savings institution that was alarmed at the activity would have the option of redeeming the stock, thereby avoiding the risk to its net worth. With today's mandatory membership, however, the institution does not have that choice.

The ability of the banks to engage in new activities should be rigorously circumscribed. The crash of the FSLIC has demonstrated the dangers of institutions trying to grow their way out of their problems by engaging in new activities. For the remaining healthy savings institutions, having resisted the temptation to take that course as principals, they do not need agents to do it for them.

Finally, pressures to ease the entry requirements for commercial banks and credit unions should be resisted.

FIRREA opened up membership in the Federal Home Loan Bank System to commercial banks and credit unions. It mandated stock requirements for banks and credit unions to make the stock purchase requirement for these new entrants at least somewhat comparable with those for savings institutions.

Barely a year after the passage of FIRREA, certain Federal Home Loan Bank interests are seeking the virtual elimination of those requirements. We categorically oppose this initiative.

We object, on procedural grounds, that a question that raises so many complex issues should not be adopted within the context of a conference on a housing bill without the benefit of hearings.

While the bank system is under some pressure, the analysis I have provided shows that there is no reason for the panicky move of changing new entrants' stock requirements without thorough hearings by the appropriate Committees of Congress.

We also object to the inequitable nature of a measure that would reduce the stock purchase requirements for voluntary members even further while continuing to hold our institutions hostage.

Some will maintain that the stock purchase requirements for banks and credit unions are more onerous than those for our institutions. This is not true. We have basically to purchase stock equal to at least six-tenths of 1 percent of our assets, whether we use the banks or not. Banks and credit unions have half that requirement and then only if they want to borrow from the banks.

I can emphatically assure you that I would gladly trade my forced requirements for their voluntary requirements.

As well as seeking a change in the entry requirements for banks and credit unions, we have heard rumors that some in the bank system are trying to gain access to the banks for mortgage bankers.

We strenuously object to admitting such non-portfolio lenders to the bank system.

Mr. Chairman, we do not believe that Federal Home Loan Bank membership eligibility requirements should be changed without a thorough inquiry by Congress. In that regard, let me finish by congratulating you for the timeliness of the current hearing.

I will be glad to answer any questions you or any members of the subcommittee may have.

Thank you.

[The prepared statement of Mr. Duncan can be found in the appendix.]

Chairman HUBBARD. Thank you very much, Mr. Duncan.

I am sure my colleagues on the subcommittee realize we do have a variety of witnesses, coming from the States of Washington, Connecticut and Mississippi, and suburban Virginia, as well as Washington, DC, so we appreciate your testimony.

We have the ABA and the IBAA here. Do they see alike? Well, looking at a passage of each of your written statements on the last page of your statement, Ed, you say, "You asked us, Mr. Chairman, to testify specifically on whether commercial banks are finding Federal Home Loan Bank membership an attractive option. The answer is generally no."

Well, Mr. Sheldon Pollock says, on the first page of his testimony, "The answer is yes." Well, is the reason for your differing points of view the fact that one of you represents some large commercial banks, among others, and one represents all community banks?

Do you want to lead off on that, Ed?

Mr. YINGLING. Mr. Chairman, I don't think there really is any difference. I would say we would think that banks would be very interested in joining the system. There are a number of benefits in joining the system, but that very few who either qualify, or because of the stock requirements would want to join for business reasons.

I would presume in Mr. Pollock's case, he looked at his balance sheet and determined that he was one of the few banks that really could take advantage of it and has found it to be a valuable institution for him to join, but I would let him comment on that.

Chairman HUBBARD. Please do, Mr. Pollock.

Mr. POLLOCK. Mr. Chairman, our bank did find it very advantageous, and I find generally the smaller banks that are involved in extensive home mortgage lending do find it more advantageous. As a commercial bank becomes larger, the advantages disappear.

Also, however, there is one other thing: We analyzed the stock of the Federal Home Loan Bank of Boston, and we found that to be a satisfactory investment. I do not know what the—what the other commercial banks in other parts of the country have done with respect to their analysis of the stock of the Federal Home Loan Banks.

There was a study done just before the passage of FIRREA by one of the Big 8 accounting firms that said, in effect, as long as the FIRREA obligation was not too great, we could continue to carry that stock at par.

However, if the fixed FIRREA obligation eats away at the earnings of those banks, it may well force a general write-down by the

entire banking industry of that stock, which could cause a tremendous drain against capital.

Mr. YINGLING. I would just add briefly that he raised an important point. That is, we advised our members that they must look at this bank by bank, and look at the dividends that are being paid by individual banks, and the future of those individual banks.

I think Mr. Pollock is from a region of the Home Loan Bank System that is perhaps paying higher dividends than some of the other regions.

Chairman HUBBARD. Thank you very much. Both of you are good gentlemen who are kind enough to be witnesses before us.

Admiral—Bob Duncan, one of the recommendations in your written testimony is making membership in the bank system voluntary for all institutions. I asked this question earlier to Mr. Chuck Thiemann of the Cincinnati office, but exactly what sort of voluntary membership would you advocate?

For example, what kind of stock purchase requirements would be imposed? How easy would you make it for member institutions to leave or exit the system?

Mr. DUNCAN. Well, one of the things in the written testimony that we submitted in advance was in a letter that was addressed to Chairman Gonzalez, and on the second page in there, it discusses the amount of stock that is required on a voluntary—on a voluntary basis from the Federal Reserve.

And the Federal Reserve only requires the stock to be purchased to the extent of 3 percent of the net, worth or capital of a commercial banking institution. If Magnolia Federal Bank did not have to buy more than 3 percent of its capital or invest 3 percent of its capital in the Federal Home Loan Bank of Dallas, I would probably not be up here testifying today, but we have so much more that we have to invest in there that it really becomes risky and becomes burdensome for us.

So, I think there is a great deal of difference between the amount of investment and whether it becomes voluntary or not, and I think those two things are a little bit interchangeable.

Chairman HUBBARD. One last question, this will be for Admiral Hughes. On page 4 of your written statement, you say, and I quote, "The National Association of Federal Credit Unions neither advocates nor discourages membership in the system." You do point out, however, on the need to educate your members on the requirements and advantages of membership in the Federal Home Loan Bank System.

In your capacity as President and CEO of an outstanding credit union in suburban Vienna, VA, what is your personal opinion on the advisability of credit unions joining the system?

Admiral HUGHES. Again, as has been discussed before, my colleagues speaking of banks having differences, it really is a management decision for each credit union. It depends on what your mission in life is and credit unions have quite focused missions in life, in that they serve a group of people that have a certain requirement. Some of them have more investment requirement. Some have more loan requirement, and so forth.

So, it really depends upon your mission in life what would be attractive to you. In the case of Navy Federal Credit Union, we don't

have a liquidity problem at this time, so that is not a big deal. We have a pretty good secondary market outlet, and we make all of our first mortgages meet secondary marketing requirements.

So, we really do not have trouble moving capital so that we can sell it on the secondary market and continue to give a large portion of our assets to consumer loans. So, it just depends on the mission you have.

Chairman HUBBARD. Congressman Parris.

Mr. PARRIS. The hearings and questions on this issue are very difficult because it's a complex, broad issue. It's trying to summarize War and Peace in three sentences.

I wish we had an hour to discuss this matter with these experts, and I very much appreciated their testimony.

Let me just say that Admiral Hughes, the Navy Federal Credit Union has one million members. Forty-four thousand of them live in my district. Could I carry your bags to the car, Admiral?

Admiral HUGHES. I am one of them, sir.

Mr. PARRIS. I know you are. Would you care to have a ride home or anything?

If I could presume to summarize your testimony, you say in parts that so long as the system is not required to carry additional thrift burdens, and the continued existence of the structure as an element of doubt; so that is the reservation, I gather, that credit unions have, a pinch fund that I mentioned yesterday joined the system.

They have apparently resolved that, that it was not a burden to be terribly concerned about. But I gather your individual institutions are looking at that with kind of a jaundiced view about what the Congress of the United States may do, as much as what we have done.

Is that correct?

Admiral HUGHES. That is correct. The precedent has sort of been set.

Mr. PARRIS. Many of us share that concern with you, Admiral, and obviously time will tell. But I hope your concerns are unfounded in that regard.

Let me just say to Mr. Duncan, you made mention of the very interesting fact which has been pointed out before, that the Federal Home Loan Bank Board was not in jeopardy until the Congress drew them into the savings and loan situation.

You may not know how your life could be any more frustrating or complex than it is, Mr. Duncan, but the Congress will figure out a way to make it that way, you can count on that. That is our best thing.

You also mentioned in your statement that lowering the already low QTL threshold for membership of new entrance into the system was atypical to the housing mission of the Federal Home Loan Bank System.

And my question to you, Mr. Duncan, as Mr. Pittenger seemed to suggest, that it would be desirable to lower the QTL test for thrifts. Isn't your observation that, or is your observation intending to say that if you lower the QTL test for new entrance, presumably mostly, if not all, voluntary and maintain the current requirements

for involuntary participants, then you have got an unbalanced fight field?

Mr. DUNCAN. Absolutely.

Mr. PARRIS. So that Mr. Pittenger's position is not contrary to that taken by you?

Mr. DUNCAN. It's absolutely necessary that you all revisit the matter of the QTL, and let's get that corrected.

Mr. PARRIS. Okay.

I think that is where everybody is coming from. I would—speaking as one member of this committee, I would hope so.

Finally, one last question, Mr. Chairman. Mr. Yingling, I find your testimony very disturbing, not because of what you say, but of the enormous questions that it raises and the potential for expense and mischief of the future of the Treasury Department and the solvency, if you will, of the Federal Government.

God knows, we got enough problems with the savings and loan situation without getting into the industry that you represent in some kind of a major player role, in terms of Treasury obligations and Federal taxpayers costs and that sort of thing.

And I read with some interest your written statement about the differential requirement between thrifts and banks, and in terms of the following changes which would have greater participation by banks, which I think would be desirable.

As you know, we have already talked about the amendment. I thought that was the best way to do it.

If I understand the current law, banking institutions have a limit on advances that can be issued to them of a maximum of 30 percent of the total advances, and you make mention in your testimony that nonthrift advances, nonthrift institutions have, there is about 120 billion of which 40 billion is to nonthrift institutions at the moment.

And if we eliminated the 30 percent limit on bank issuances, that would be a giant step forward. Is that one of your principle recommendations to this committee?

Mr. YINGLING. It is, Congressman. I don't think it's something that is going to have an impact right away because we, of course, are not anywhere near the 30 percent limit. But as the S&L industry shrinks and the banks take over more in the mortgage market, and if you also allowed a broader entry by banks, then that 30 percent limit, not just on banks but on all nonthrift members, would come into play.

Mr. PARRIS. Are you coming at that issue from the point of why not make an expanded market by reducing the legislative requirements of the 30 percent? I mean, why not give the opportunity if banks see fit, management decides to do so, to eliminate or amend or in some way deal with an arbitrary limit?

It's just like the drinking age; is it not?

Mr. YINGLING. Well, gee, I think it's even more arbitrary than the drinking age.

Mr. PARRIS. Well, perhaps, yes. But if I understand where you are coming from, the stock requirements are one thing. I mean, we can argue about whether that is fair or not, and apparently it's not in your opinion. But if you want banks to engage in mortgage finance, and to utilize the Federal Home Loan Bank System to do so,

which presumably will want to, then the reduction of the 30 percent limit or the elimination of it or whatever we do would be a desirable thing to do.

That is your point, is it not?

Mr. YINGLING. It's my point. I question whether or not it would come into play if you don't make the other changes, as well, because you just won't have that many other banks joining.

Mr. PARRIS. So you kind of got to do it all at once or it won't matter once what you do. You change the QTL test and don't do the stock, then they probably won't do it anyway, and the management decision will be, there is no benefit. As Mr. Pollock indicated, he wouldn't do it if it wasn't good for his institution.

So he found it attractive, others have not.

Mr. YINGLING. That is right.

Mr. PARRIS. If we don't make it a desirable thing to do, then you are not going to do it anyway; is that right?

Mr. YINGLING. That is right.

Mr. PARRIS. My time has expired.

Mr. BARNARD. Mr. Parris, I think Admiral Hughes, if he had a choice, he would rather for you to talk about taxation and some other things rather than carry his briefcase.

Mr. PARRIS. One thing I am not going to suggest is that we put all the insurance funds together, Mr. Barnard.

Mr. BARNARD. Mr. Yingling, in your testimony, I understood that you said that banks joining the Federal Home Loan Bank System would, there would be some duplication in services. Are you speaking of services that are now available by—and I think you mentioned one, bankers banks, and the Federal Reserve Bank? What duplication would there be there?

Mr. YINGLING. Well, first, Congressman, it's my understanding that banks don't even have to join the Home Loan Bank System to get these correspondent services. They are being offered whether or not you join the system.

Mr. BARNARD. What are some of those services?

Mr. YINGLING. Well, lock box services; I think any type of traditional correspondent banking service could be offered if they are not already by the Home Loan Bank System. Check clearing is another example. They have got a whole bunch more for you.

There are a number of concerns there. On the one hand, this can be good for banks because they could get some low cost correspondent banking services.

On the other hand, we have been through this once before, as you know, in the Monetary Control Act with respect to the Fed, and the Congress took a good look at it and said, well, here's a government entity, the Fed, that is providing correspondent banking services, and we want to write into the law what their role should be in that area.

Our concern would be that we have another government-type institution, a GSE, out here, that may be starting down that line very aggressively. And all we are suggesting is that the Congress ought to take a look at it and determine what their role should be.

Plus, they are going to be competing directly, not only with private providers but with the Fed.

Mr. BARNARD. Admiral Hughes, did you testify, are there any credit unions now that are members of the Federal Home Loan Bank System? One?

Admiral HUGHES. Yes, sir. There is one that just joined recently within the last week. There are, as I understand, about 16 more that are interested. And I think that most of the credit unions have looked at it, and they are trying to see whether the shoe fits or not and whether it's worthwhile for them to do it.

Mr. BARNARD. Mr. Pollock, how do you feel about the QTL test?

Mr. POLLOCK. I would like to see it reduced, because we basically have, that is it, a double requirement. However, we have been a heavy home mortgage lender, so in my particular case, it's not as onerous as it is in some of the others.

But it should be reduced. It should be revisited. And we are not even objecting if it's reduced for the savings and loans, too. It may be a little bit unfair to them.

Mr. BARNARD. Is your membership costing the Federal Home Loan Bank System greater than some of your competing savings and loans in the area? It would be ordinarily, wouldn't it?

Mr. POLLOCK. Probably it's for the stock requirement, yes.

Mr. BARNARD. I don't have any further questions.

Thank you very much.

Chairman HUBBARD. Congressman McCandless.

Mr. McCANDLESS. Admiral, I find myself in a little difficult position than my colleague, Mr. Parris. It seems that because I wouldn't sign a contract with my local credit unions to support three basic policies, that they endorsed my November opponent, so I don't have to worry about carrying your briefcase. I have already lost the keys to the car, so to speak.

Admiral HUGHES. Mr. McCandless, that may be related to the other trade association, sir. I represent NAFCU.

Mr. McCANDLESS. Well, two state credit unions and three Federal chartered credit unions involved in it. But that is neither here nor there. That is they way life is.

The question that I have, we are talking here about a lending of money for housing. And when the credit unions were established in their nontax status, a part of that establishment, their mission in life was, to sum it up, to loan to members at low interest rates, short periods of time, small amounts.

And credit unions now are involved in long-term, fixed rate loans. The numbers of credit unions in recent years has expanded rather dramatically. We have a charter that is both state and Federal, and so one could take a look at that and say are we headed in a direction that we have just come from in another institutional system?

The fact that it's a nontaxpaying institution, financial institution, but yet it's getting involved in direct loans, I mean, direct investment, long-term fixed rate loans, is the credit union still entitled to its tax-free status when it moves into these areas that have been for many, many years savings and loan and banking institutions area of endeavors?

Admiral HUGHES. Mr. McCandless, a couple points I would like to make in response. First of all, I think that the credit union numbers are not expanding, and the figures would support that. The

initiation of credit unions for loaning money from one member to another, not for profit, not for charity, that is really a key point.

There were credit unions in the very beginning of credit unionism in this country that were involved in mortgages very heavily; and, as a matter of fact, one of the earlier ones up in New England area, I believe, was almost all mortgages.

So, it's not the purpose that the money was put forth for or the terms, but rather it was the use of members' money to help others in borrowing.

So each credit union, I think, has a different challenge in life, and the purpose that the money is loaned for, I don't think is material. It's to take care of the members' needs.

I think I also mentioned that the NCUA has guidelines out whereby they say that if you have more than 25 percent in long-term loans that they will look at it closely with their experts. They do not bar it, but there are guidelines out, and the experts will make sure that you are not getting into a problem of asset liability management or anything like that, that there is a balance in the funds that you have available.

So the regulator rate is very conscious of this point that you bring out of getting into too much long-term loans and getting involved in too much interest risk.

So I think that there are concerns about that, and that there are regulations and oversight that will prevent its going down a bad track.

Mr. McCANDLESS. You speak for Federal credit unions.

Admiral HUGHES. Yes, sir, Federal.

Mr. McCANDLESS. We still have those state chartered institutions that benefit from the same type of insurance fund that you Federal credit unions benefit from.

Admiral HUGHES. They are not members of NAFCU which I represent here today, but the state chartered credit unions who desire to have Federal insurance with NCUA and the NCUSIF Fund, insurance fund, may apply for it. And there are many credit unions that are in that category.

Mr. McCANDLESS. Well, I would venture an opinion that probably 90 percent plus are insured by the credit union fund, aren't they? State chartered?

Admiral HUGHES. I would really doubt that figure, but I don't know. John says that that may be true. I didn't think that it was that much.

Chairman HUBBARD. John, referring to NAFCU's legislation representative, John Zimmerman.

Mr. McCANDLESS. All right. Well, you have answered some of my questions. I saw some figures on the growth of credit unions in the 1930s and 1940s and 1950s, which was very impressive, very large. Maybe they have tapered off now in recent years, but there was huge growth in those periods.

I guess my concern is that 88 percent of the losses currently from the savings and loan problem have come from state chartered institutions.

And so I guess Mr. Seidman, when he addressed the group in Phoenix, started a fire, a forest fire or a big fire or whatever you want to call it, fire storm with credit unions, because they feared

that they were being threatened now by some type of devious act on the part of the other institutions to undermine the strength of the credit unions.

I don't see it that way. I think there is a place to play in credit unions, but I have a problem with the investment, utilizing members' investments for shopping centers and that kind of thing.

I never pictured credit unions as having that kind of position to play in the financial institutions.

Admiral HUGHES. Well, speaking for Navy Federal, we do not get involved in any commercial loans whatsoever.

Mr. McCANDLESS. We have talked about Navy Federal at quite length, and they are an institution that has a very high standing in the financial world, this is fulfilling a task in many areas where, or a service where it's not profitable to them.

Examples have been given me, and I compliment you for that attention to the social needs of communities.

Did you have something, Mr. Pollock?

Mr. POLLOCK. Yes, Congressman McCandless. The problem that the smaller commercial banks and larger commercial banks have with the credit union situation is when they go after a broad field of membership, as we all understood it was supposed to be, limited to this group or that group, no one has too many problems.

But there have been instances around the country of very aggressive credit unions that are basically using the tax benefits to go into the banking business, period, for the general public, that the field of membership is almost embarrassingly silly.

And we do have to object to that, and I know that isn't quite the subject of this hearing.

And, you know, I am waiting for you to get back to your question in the original opening statement because I think that is even perhaps more important today.

Mr. McCANDLESS. I think probably the Chairman has been very gracious with my time, so I better relinquish what time I have overused and thank you, Mr. Chairman.

Chairman HUBBARD. Go ahead.

Mr. McCANDLESS. Well, let's pop those two questions, then, the regulators and how they are overreacting. They come in and stop talking to people that you have known for 30 years and have a lot of respect for who are in these financial institutions, and all of a sudden, it's protect my back side at the expense of the operation of the institution itself, with questionable bearing upon the regulation aspect of it and overreaction.

It's like the pendulum democracy when we react, we overreact, and it takes a long time for that pendulum to get back to some semblance of normalcy because it swung this way and now we are going to do it the opposite way.

Where are we in that thing? Are we going to straighten that out pretty soon?

Mr. POLLOCK. I certainly hope so, but I cannot say that I see much evidence of it. As an example, in 1981, one of these accounting boards passed the In-Substance Foreclosure Rules, in response, I think, to the Third World debt. We were examined nine times since that time, as were all the major banks in New England and throughout the country. Not once, not once did any examiner ever

raise the issue of In-Substance Foreclosure. And then when the comptroller currency was brought to Connecticut by the entire Republican and Democratic delegation and got up and said that we haven't changed anything.

No, it's true. The rule was on the accounting books, but they never enforced it. They never came out with that until the zealots came in. And you have a situation now that the regulators are so frightened of anything that smells of development or that kind of loan, that it's almost automatically classified and automatically reviewed.

So the bankers are frightened. You have the other problem, where they are insisting on higher capital standards at a time when there is no market for stocks. None of us can raise it. J.P. Morgan cannot get you bank equity today. So there is only one solution, and that is to shrink.

The first step is to start pushing loans out, and whose loans do we push out? The better borrowers, because they can hopefully go somewhere else, or the people that can least afford it. Out they go.

Then we can reduce the deposit side, and we have done a very good job. But what we have done is thrown the earning assets out of the bank. We have destroyed the New England economy.

A year from today when you meet on this, you are going to be discussing what is coming down the entire East Coast. What is spreading from New England to Georgia to Florida, Washington, New Jersey, is a total—we are unable to lend.

The banks, the oil that moves the industry and jobs, we are not putting the money out. And we can find good loans if we could get some relief on the capital.

I should keep my big mouth shut.

Mr. McCANDLESS. I like your editorial. It can be applied to the West Coast, as well as the East Coast.

Mr. POLLOCK. Well, my friends on the West Coast, a lot in the mortgage business. It's not nearly as bad in Florida or in California, because you have population growth. But take the areas of the country where the population growth is not so much, and you see it becomes a much more difficult problem.

Add to our problem the lower defense spending we relied very heavily on, the high price of imported oil, two-thirds of New England's energy needs comes imported, so our costs have skyrocketed. Our manufacturers cannot compete with other manufacturers in other parts of the country because of that, and you have the real estate problem.

Chairman HUBBARD. Let me ask one question and we will go back.

One of the most interesting hearings our subcommittee has held this year was in Hartford, CT. Our subcommittee had a hearing at your state capitol, and among those who testified, we started off with Senator Chris Dodd and some Congressman from Massachusetts, and then the head of the Massachusetts Association of Realtors and others.

They were commenting about the economic problems of New England, especially the real estate market crisis. I just mention to you one comment you made earlier today. You said a wider membership base of the Federal Home Loan Bank System would not

only benefit housing and home ownership, but it would also provide much needed employment.

What you just said about how bad it is in New England and the oil crisis, would the wider membership basis, it would make a difference?

Mr. POLLOCK. Well, the first step, of course, is that if we could get more capital under FIRREA, you gave the FDIC the power to put net worth certificates into the banks. You put a couple of sections. One, if their capital is under 3 percent but over 10, you are going to get something else. And then you said notwithstanding another fact, they can put more in.

I went over there this morning and spoke to them about just doing that in New England and waking up. They have opened an office up in Framingham, MA, and they are going to staff it with 480 liquidators. This is from the RTC liquidation mess. I don't know what they expect up there. Unless we get the capital, we cannot grow the assets.

We get the capital, if you presume an 8 percent capital is required, we can grow the banks 12 times. We can get 12 times that on a million dollars in capital. We get \$12 million in deposits. Presuming we can get good loans, we can start putting that back out and getting jobs and getting other things.

Chairman HUBBARD. Congressman McCandless.

Mr. McCANDLESS. I am going to ask the other question to you and Mr. Duncan. I have a group of savings and loans, traditional type savings and loans in what is referred to in the inland empire of Riverside and San Bernardino Counties. They are all healthy.

Back in 1985, when we talked about the idea of a single financial institution, they threw up their hands, called me a traitor and almost made me pay for my own lunch. Not now. Okay.

So now we come to 1988, 1989, and we go back to our regular routine of meeting. Now, they are saying when? And I find it kind of interesting, because 75 percent of one bank, one institution's portfolio is in single family housing, another 60 percent, all of them were 50 percent.

As the time come to merge these two, to go to the line no more and say what you want to do, here's a menu, pick it out, whatever your Board of Directors feel comfortable with, do this, offer this, and maybe this is something you will look at in the future and call yourself a savings bank or a bank or whatever you want to call yourself.

Mr. POLLOCK. In 1985, the Parity Law was passed in Connecticut giving thrifts the same powers as commercial banks.

Mr. McCANDLESS. With state charters.

Mr. POLLOCK. Connecticut. There essentially is no difference, but some banks have chosen to go in more heavily into home mortgages, others into other types of investing.

And I think it's absolutely proof positive that we are generally, until this debacle of the past year, we have had strong institutions.

The problems in New England are not caused generally, overwhelmingly by mismanagement. It's caused by economic conditions, and the fact that you have a charter that says savings and loans or savings bank or trust company means nothing.

You wouldn't have the same powers. Many of the thrifts that are in trouble did jump into the commercial lending. They said, well, that is the field. They hired a bunch of commercial bankers and said that is how we have to go. They botched it up. They tried to do too much too fast.

And what you are saying basically is leave the decision to the management of the bank. If the management of the bank, under supervision of its regulators, feels that they have an expertise in a niche of banking, go to it, make some money, that is fine.

If there is an opening in the marketplace for someone to do home mortgages, then do it. If it's the mortgage bankers that should get into the Home Loan Bank and they are providing the service, fine.

Under proper controls, there are reasonable controls that have to be put in. But why not? What is so mystical about that? I find it very easy.

We have it in Connecticut. The only difference is the name.

Mr. McCANDLESS. Mr. Duncan, you come from another part of the country. What are your thoughts?

Mr. DUNCAN. I also come from a different type institution, and since 1985, we had the Scarlet Letter put on our door.

Mr. McCANDLESS. In northern terms, what does Scarlet Letter mean?

Mr. DUNCAN. Well, the reputation of good institutions and bad institutions that are thrifts have all been tarred. And frankly, I don't think we are going to get rid of the tar unless we can get a new name and a new start and a new charter.

There are those in our industry—and it's divided. There are those that think that we would like to go in one direction and others that would like to join and become the same as commercial banks. That is not a settled issue, and that would have to be an issue that Congress is going to have to settle.

But I don't think anybody that has been in the savings and loan business really would like to stay exactly where we are today. It's very uncomfortable.

Mr. McCANDLESS. You have been very gracious with your time, Mr. Chairman, and I appreciate it.

Chairman HUBBARD. You will be pleased to know that in Kentucky, the savings and loans have a good reputation, and they are healthy and viable.

Mr. McCANDLESS. They are all the bluegrass town there, and all those horses and stuff.

Mr. DUNCAN. Mr. Chairman, they may, but if they get on an airplane and go someplace and tell the fellow in the chair next to them that they are in the thrift business, they are all pictured as being next to Mr. Keating. And I don't even tell people when I get on the plane any more than I am in the savings and loan business. I tell them I am a CPA.

Mr. PARRIS. You ought to get into politics, Mr. Duncan.

Chairman HUBBARD. How would you like to sit there and tell the man you are a Member of Congress?

Mr. McCANDLESS. That is something I never do on a plane.

Mr. DUNCAN. I think with that, I will plead the Fifth.

Chairman HUBBARD. Congressman Parris.

Mr. PARRIS. Thank you very much, Mr. Chairman.

I just have one observation. I have—I am genuinely grateful for you gentlemen, your presence here today. I found your testimony very helpful and very thought-provoking, and I mean that sincerely.

I just have one observation to make, and Mr. Pollock, your definition of the scenario that exists out there in the real world, and is impacting on real people is happening in real communities like mine.

It has reached here. There is a circumstance that exists, and I will share with you the frustration, at least my frustration with having the regulators sitting at a table just like this saying, we didn't change anything, nothing has changed, and we all know that is blatant nonsense.

The balanced assertion that something different isn't happening out there is simply absurd.

Now, whose fault is it and how we got there, and so forth, is a little academic. The point is that it's enormously important that we try to correct it. In a flat economy with all the circumstances—and I will not give a speech about all that, Mr. Chairman, I assure you, but there is trouble in River City.

And the simple suggestion that some \$21,000 a year bank examiner ought to come in and tell some guy that has been in the business for 50 years that his best customer who has a performing loan ought to get reserved is nonsense.

Mr. POLLOCK. Well, that's, it's a performing, nonperforming loan. It's a new term. It defies common sense, and unfortunately, we have to live with those rules. They regulate us. That is the rule.

Mr. PARRIS. There are some of us, and I don't mean just me, I assure you, around here who have some modest understanding of what you are talking about and some of the implications of all this in the real world and the economy of the United States, and what it's doing to real people.

Mr. YINGLING. If I may briefly, it goes beyond just the regulatory problem. I know of examples of where banks have not made real estate loans that were perfectly good loans for the simple reason that they would end up in the real estate column, and the papers are printing your percentage of real estate versus your percentage of capital and that ratio concerned to knock down your stock price.

So they have simply said we cannot even afford to make dead solid loans because of the atmosphere in which we are operating right now.

Mr. McCANDLESS. Therefore lies the problem in California.

Mr. PARRIS. To go back to what Mr. Duncan was referring to, aside from the personal sensitivities of the categorization of your industry, Mr. Duncan, the for sale signs in Northern Virginia are beginning to come out of the ground like dandelions in the Spring, and nobody can buy anything. And you cannot sell anything without a dramatic reduction in value because there is no financing.

And they said well, there is plenty of money there for single family homes. Oh, really? Tell me about it. When you talk about home builders who have enormous inventory of product and cannot give them away, you think that doesn't impact on truck drivers and carpenters and secretaries and all the rest of it?

It's the ripple effect in a flat economy, and we better do something about it.

Mr. POLLOCK. Suppose I were to tell you I will give you a zero interest loan for a new car, and you are an auto dealer, and you cannot sell it. You cannot get anybody to come into your showroom. You see the Big Three problem. You see what is going on. It's not just in real estate any more. It has spread out all over, and it's very serious.

The newspapers in our area, God forbid, ad lineage are down so much they are all laying off. They don't have enough business. It's creeping throughout the system.

So all we ask is we get enough capital so we can start putting some money back into the system. Lower rates would be good, but I don't know that that would be the only thing. You know, we all ask Mr. Greenspan, lower the rates, lower the rates, do something for us. We have zero financing in autos, and nothing is happening.

I think the problem is a little deeper.

Mr. PARRIS. Maybe we have a real downturn in the confidence of the average American on safety and soundness in the future of the economic structure of this Nation.

Mr. POLLOCK. You hit it on the head. That is exactly what it is.

Chairman HUBBARD. At our hearing in Connecticut, the regulators were saying there that they haven't changed anything, but the bankers refuted that as being incorrect. I think my colleagues—

Mr. McCANDLESS. Mr. Chairman, I want to make it clear here that I am not advocating a loosening of the regulations. I think the banks have been fairly well regulated over the years, based upon the experience of the people that I come in contact with, independent banks, small banks, in my district.

It's the new interpretation and the implementation of those new interpretations to the regulatory process, as Mr. Yingling pointed out.

With respect to real estate loans, it's no longer a good idea to have real estate loans, irrespective of how well performing they are, the amount of down payment or whatever, because of the stigma that real estate loans have on some type of a balance sheet.

These are the concerns that I have, and I believe that those are the concerns that Mr. Parris was also expressing, so that somebody doesn't say well, they want to loosen the regulations so that the same thing can happen in the banks.

Mr. POLLOCK. Mr. McCandless, none of us want to loosen regulations. We want fair regulations, but we need the capital to pull out. We will live with the rules. If those are the rules, we will do it.

But Mr. Yingling is right, we are shying away from certain types of loans right now, because one, the economy, but also because of the fear of what the regulators will do to us.

Mr. McCANDLESS. Thank you.

Chairman HUBBARD. Again, thanks to my colleagues on our subcommittee and thanks to our excellent panels, one and two, and a major part of the hearing today is because of our excellent staff. The Staff Director, Mary Martha Fortney; the Minority Counsel, Mike McGarry; Sam Woodall, Professional Staff Member; Kim Trimbull, Minority Staff; and Joey Lucas, Press Assistant; and Julie Bryan and Paula Satkins, our necessary and helpful, too,

court reporters—or excuse me, not court reports, but hearing reporters.

Thanks to each of you who have been here throughout this 3 hour and 15 minute hearing, and with that, our hearing is now adjourned.

[Whereupon, at 5:15 p.m., the hearing was adjourned.]

APPENDIX

October 10, 1990

Statement of the Honorable Chalmers P. Wylie
Subcommittee on General Oversight and Investigation
October 10, 1990

I want to compliment you Chairman Hubbard for holding this hearing today. It has now been just about 14 months to the day since the President signed FIRREA. Under FIRREA, the Federal Home Loan Banks were required to contribute \$3 billion in retained earnings and surplus as well as \$300 million per year toward the cost of resolving failed S&Ls. In the post-FIRREA environment the Bank System is faced with the loss of a large percentage of its customer base as insolvent thrifts are liquidated. And the impact on the System has been not inconsequential. As of June of this year assets are down 16 percent from June of 1989, and earnings have fallen almost 25 percent.

So this hearing is certainly timely. We have two very significant interests in protecting the stability of the Bank System. The first is, of course, to ensure the continued ability of the Banks to make their FIRREA-mandated contribution to resolving the thrift crisis. The second interest is directly related to the very important fundamental mission of the Federal Home Loan Bank System -- promoting housing. In my opinion, a strong Bank System is critical to the continued existence of the thrift industry which, even after many reverses, continues to put the dream of home ownership within the reach of millions of Americans. And on this front I would make two observations. First, we should begin to consider avenues to broaden the customer base for the services provided by the Banks. And second, to maintain confidence in the Bank System we should put to rest any concern over the sanctity of the \$11 billion in Federal Home Loan Bank stock member S&Ls are holding. The Home Loan Banks were required to make the maximum possible contribution in FIRREA.

Impairing in any way that stock which represents almost 25 percent of the tangible capital of the thrift industry would be counterproductive and this Member, for one, would oppose such action. I hasten to add that I am not aware of any such proposal, but it is a concern that has been raised by some in the thrift industry.

Finally, Mr. Chairman, I would like to personally welcome Chuck Thiemann. Chuck has served with distinction for many years as President of the Federal Home Loan Bank of Cincinnati. He is knowledgeable, straightforward and I have relied on his advice and counsel over the years.

Thank you.

TESTIMONY OF CHARLES LEE THIEMANN, PRESIDENT
FEDERAL HOME LOAN BANK OF CINCINNATI

BEFORE THE
SUBCOMMITTEE ON GENERAL OVERSIGHT
AND INVESTIGATIONS
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U.S. HOUSE OF REPRESENTATIVES
WEDNESDAY, OCTOBER 10, 1990
2:00 P.M.

Mr. Chairman and members of the Subcommittee, I am Charles Lee Thiemann, President of the Federal Home Loan Bank of Cincinnati. I am accompanied today by Brian Dittenhafer, President of the Federal Home Loan Bank of New York, and Robert E. Showfety, President of the Federal Home Loan Bank of Atlanta. We appreciate the opportunity to appear before you today and to share our viewpoint on the condition of the Federal Home Loan Bank System and its ability to perform its responsibilities.

The Federal Home Loan Bank System has been charged with a central role in supporting and fostering financing for home ownership at every economic level in the nation. It has been just over one year since the passage of the Financial Institutions Reform, Recovery and Enforcement Act ("FIRREA") which reaffirmed the central role of the FHLBank System as a source of funds to home financing and extended the responsibility of the System to the support of low- and moderate-income families.

It was also about one year ago that I and two other Bank Presidents had the privilege of addressing this subcommittee. The subjects on that occasion were the prospects of the FHLBank System and the possible impact of disparities which might occur between individual FHLBanks as a result of the passage of FIRREA. Also discussed was the

ability of the FHLBank System to adjust to its expanded mandate and additional financial responsibilities.

It is our hope that our testimonies today will serve as an update on the initial projections presented last year. You have asked that we comment today on the condition of the Federal Home Loan Bank System one year after the passage of FIRREA. Also, you asked that we address whether the individual banks within the FHLBank System have been unevenly affected by FIRREA, the extent to which commercial banks and credit unions have found membership in the FHLBank System attractive, and whether the number of Federal Home Loan Banks should be adjusted. We will begin by outlining some problems and concerns which were not fully evident to us a year ago. In addition to addressing the specific questions raised, and with your indulgence, we will make a few suggestions which would substantially improve the ability of the FHLBank System to meet the goals set for us by the Congress. We think these proposals are fully consistent with the goals of public policy in housing and the support of low- and moderate-income housing, yet would not require additional costs to the taxpayer or conflict with other public policy goals.

If I might, I will begin with a summary of the experience of the FHLBank System in the period since the passage of

FIRREA. I would like to consider the financial changes which have occurred, the initial success of the Affordable Housing Programs, and our ongoing commitment to community investment programs.

Condition of the Federal Home Loan Banks

The basis of comparison which I have chosen is the period from July, 1989 to August of this year. This is the period just preceding the passage of FIRREA to the most recent published data on the FHLBank System. The patterns which I note in my discussion have continued to the present.

During its 58 year history, the Federal Home Loan Bank System has never suffered a loss as a result of our lending to members of the FHLBank System. In the recent reviews of Government-Sponsored Enterprises ("GSE"), the FHLBank System receives high marks for its financial stability and investment worthiness. It is our goal to ensure that we continue to meet those high standards and perform the functions for which we were created and re-dedicated last year.

At the end of July, 1989, the FHLBank System had total assets of \$193.6 billion and advances to member institutions of \$159.7 billion. By August, 1990, total assets have

decreased some \$33.4 billion, approximately a 17% decrease, and advances decreased \$37.7 billion, a 24% decrease. The reasons for the decreases relate primarily to the reduction in the size of the thrift industry which constitutes the preponderance of our membership and asset base.

In the period preceding the passage of FIRREA, the lack of funding available to the FSLIC had forced the FHLBank System to lend substantial amounts to maintain member liquidity. These fully secured advances have been substantially reduced as the Resolution Trust Corporation ("RTC") has sought resolutions with the funding available to it. The capital requirements imposed upon thrifts by FIRREA and the reduced activity in housing markets over the past year, together with the transfer of institutions to the RTC, have been the major contributors to the decline in lending and, therefore, FHLBank System assets. We expect this trend to continue for the next year or two as the thrift industry restructures by shedding assets to meet its capital requirements and the RTC goes about its business of resolving the remaining insolvent thrifts. During the period beginning in August, 1989, the FHLBank System has also written off its \$680 million holding of Financing Corporation ("FICO") stock and transferred \$2.36 billion of retained earnings to the Resolution Funding Corporation ("REFCORP").

The total capital held by the FHLBank System at the end of August, 1990, was \$11.8 billion, a reduction of \$4.5 billion, approximately 27%, over the past year. Transfers to the REFCORP have reduced capital at a faster rate than assets, which in turn, has reduced the capital to asset ratio of the FHLBank System from 8.4% to 7.3%.

In examining our current capital position, we find that the limited default risk in our asset base and our minimal interest rate risk contributes to our confidence that the capital position of the FHLBank System remains strong despite the loss of our retained earnings. I am confident that all the Presidents in the FHLBank System share that view. Recent studies conducted on GSE's have identified the FHLBank System as well capitalized, enough so to achieve the highest investment ratings from independent ratings services. The pace of future transfers to the FICO and REFCORP will be curtailed as the FHLBank System has exhausted its available retained earnings. Treasury Secretary Brady, for the Administration, and the Congressional Budget Office, have both concluded the FHLBank System has contributed as much capital as is consistent with maintaining a sound financial position.

Revenues from lending are the dominant form of the FHLBank System's earnings. As the advances outstanding by the

FHLBank System have declined and a substantial amount of FHLBank System equity has been transferred to FICO and REFCORP, earnings have decreased. In 1989, the FHLBank System reported a net income of \$1.8 billion for the year. Through the first eight months of 1989, earnings were \$1.3 billion. During the same period this year, net earnings are \$1 billion, a decrease of almost 24%. Although the first eight months' earnings were at an annual rate of \$1.5 billion, we expect net income to be smaller as the cumulative effect of asset and retained earnings losses occur. Given the present pattern of restructuring in the thrift industry and the reduced demand for advance borrowing, it is quite possible that 1991 net income could be close to \$1 billion or less.

Compared to last year at this time, I think we are no less resolute in our belief that the FHLBank System is financially sound and capable of meeting its financial obligations to participate in funding the resolution of insolvent thrifts, to serve as a central source of financing for home ownership, and to meet the goals established by Congress to support and increase the financing available to low- and moderate-income housing. We have had substantial successes during the past year and I think we face some significant challenges. Before I discuss the challenges and the recommendations which we think would materially improve

the future position of the FHLBank System, I would like to review what we consider to have been substantial success in meeting our housing objectives.

Housing and Housing Finance Through the FHLBanks

The Federal Home Loan Bank System has supplied billions of dollars of housing finance assistance through its advances to member institutions. Americans obtain most of their mortgages from community lenders and the Federal Home Loan Banks help community lenders make mortgage loans. Over just the past decade, the FHLBank System has provided funding to member institutions sufficient to finance 10 million homes.

The vast majority of loans to our members have always been secured by mortgages. This process not only adds to the liquidity of mortgage portfolios, it has provided a funding base which allowed millions of homes to be purchased or built, and it has allowed some separation of the access to housing finance from local capital market constraints. This is a function which we continue to provide. Our activities complement, to a large extent, the efforts of other credit agencies and secondary market makers rather than competing with them. The FHLBank System acts as a unique source of intermediate- and long-term funds to support and expand the opportunities for home ownership.

The FHLBank System has long been active not only in support of housing, but has developed targeted programs to help extend housing opportunities to all our citizens. The FHLBank System was a co-founder and long term sponsor of Neighborhood Housing Services. In 1978, the FHLBank System established the original Community Investment Fund ("CIF") which provided subsidized advances to member institutions in direct support of low- and moderate-income communities' housing and development needs. During the initial five year period of that program, some \$7.9 billion in advances were issued which was combined with \$19 billion in other funding sources to create over 571,000 units of housing.

The Community Investment Program ("CIP") mandated in FIRREA is one which we all support. Although the format of the Community Investment Fund changed over the years, in most District Banks the CIP was a continuation of the CIF programs already in place. We fully expect the CIP to provide a substantial amount of funding and to be judged a successful program. Currently, there are \$335.7 million in CIP advances outstanding to member institutions. We anticipate the program will grow as we are able to develop a broader base of low- and moderate-income development programs.

The Affordable Housing Program ("AHP") was a major new effort for the FHLBank System. It differs from past programs in only one aspect. All of the other housing assistance programs which the FHLBank System had founded and sponsored were developed by the FHLBank System without specific legislation. The AHP is an innovative program which we have pursued aggressively. One measure of the success of this program is the number of applications received, which significantly exceeded the AHP funds available in the initial two offerings. The FHLBank System set aside \$78.7 million, the maximum authorized by law, to support the first year AHP subscriptions. In the initial offering last July, \$160 million of funding was requested. The FHLBank System had available only 60% (\$47 million) of the annual funding for its first offering. These funds attracted an additional \$641 million of funds which, when combined with the AHP monies, will make available 13,706 units of housing for low- and moderate-income families. Over one-third of those units will be owner occupied and some 46% of the total, 6,238 units, will be occupied by very low income families.

Those are just the results of our first offering. Currently, we have 462 requests for \$124.1 million dollars in the second of the 1990 offerings. We have \$31 million remaining in our 1990 fund.

I think the results of this new program are spectacular in terms of the goals which were set and the minimal costs which have been incurred in administering the program. The FHLBank System has made a substantial commitment to make not only this particular program successful, but to encourage development of housing access which does not include our own funding programs. In reality, this program is an extension of what we have always done. We are successful because we have laid the foundation over the years. But we are also realistic. The prime need in these programs is money as well as good intentions, and we have limited supplies of funds to contribute.

The Challenges to the Bank System Now and in the Next Few Years

The successes in housing finance will continue only so long as the Federal Home Loan Bank System has the ability to attract low cost funds and sufficient economic opportunities to earn the income necessary to support not only the costs mandated by FIRREA, but those associated with our prime mandate -- housing finance. My review of the current status of the FHLBank System's financial condition is consistent with the conclusion that we are a strong and financially sound system, but it also creates concern that the trends,

if perpetuated, could reduce the strength of our position.

The core of the problem is bound up in some basic issues surrounding the costs imposed on the FHLBank System by FIRREA and the ability of the FHLBank System to increase its revenues through expanded membership. As you know, the costs imposed upon the FHLBank System by FIRREA are largely fixed in amount. Because the amount required for capital defeasance and interest costs of the REFCORP borrowings do not vary with our ability to pay, and to a lesser extent our contributions to the AHP are fixed, these costs are becoming an increasing proportion of our income as our asset base decreases. We must generate sufficient earnings to prevent these costs from becoming detrimental to our overall condition.

Quite frankly, in the short run it would be preferable for the System to transfer 20% of our earnings to the RTC and 10% to the AHP rather than having a fixed amount levied. The transfers during the period of transition for the FHLBank System may prove to be a much greater proportion of earnings than was intended. Over the long run, I think such an approach would provide more total funding to both than the present system.

Given the present structure, the FHLBanks must be able to

earn enough net income to meet our obligations and to make membership in the FHLBank System attractive. The probability of a continuing decrease in the asset base of the thrift industry over the next few years suggests that increases in our income must come from expanded membership.

As you know, FIRREA opened membership to commercial banks and credit unions. The FHLBank System has launched an aggressive campaign to acquaint commercial banks and credit unions with our system and to attract new members. Thus far, the FHLBank System has attracted 27 new members and applications are currently being considered for 41 additional institutions. We are very proud to have these institutions join the FHLBank System within the past year. But these new members constitute only a small fraction of the commercial banks and credit unions who are potential members. Joining the FHLBank System is an important decision and the process takes some time. But, there are at least two impediments to membership which are making the decision for commercial banks and credit unions much more difficult.

One impediment is the continuing concern that further requirements may be legislated which might involve the confiscation or a substantial reduction in the value of the paid-in capital associated with membership in the FHLBank

System. This is certainly a continuing issue with many current members and is another element of uncertainty for potential members. A clear statement from the Congress which indicates that no further requirements will be placed upon the FHLBank System would be of substantial benefit.

A second impediment deals with the disparity in the implicit benefit of membership based upon asset tests. To join a FHLBank, a member must hold 1% of its total mortgage-based assets or 30% of its total assets, whichever is the greater, in the form of FHLBank stock. The ability to access the lending services of the FHLBanks is dependent upon its status as a Qualified Thrift Lender ("QTL"). For example, an institution holding 30% of its assets in mortgages must hold 16.7% of its borrowings in the form of FHLBank stock. The ratio of required stock to advances increases as the QTL decreases. A qualified QTL borrower, on the other hand, would be required to hold no more than 5%. As the cost pressures of FIRREA take an increasing proportion of our revenues, our ability to pay dividends, which reduces the implicit cost of this increased stock holding, is diminished.

If the purpose of the Federal Home Loan Bank System is to assist in increasing the funds available for home financing and to provide additional subsidies to low- and

moderate-income housing and development, this restriction seems inconsistent with those goals. It would seem that if membership, or at least the access to advances, was related proportionally to the individual institution's commitment to housing finance as evidenced by specific types of housing collateral, the public policy goals would be better served and the FHLBank System would have increased opportunity to provide funding for its housing programs and meet its obligations to provide funding to the resolution of the thrift insurance fund crisis.

While there are currently significant benefits for membership in the FHLBank System, I believe the System will have a vastly improved probability of meeting its long term responsibilities if adjustments are made in the membership requirements, the capital requirements for borrowing, and access to FHLBank System advances. At some point in time, it will be necessary for the Congress to review the conditions for membership in the Federal Home Loan Bank System irrespective of charter type or insurance fund. I personally believe that all the members of the FHLBank System should be treated equally based upon their commitment to housing. The issue is complicated by the cost burdens placed upon the FHLBank System and the need for the System to maintain a strong capital position during this transition period. We should begin working towards a

solution which is equitable to all.

A second area of concern raised in your invitation was a discussion of any uneven affects which FIRREA may have had on individual FHLBanks within the System. An accompanying table (Attachment IV) summarizes the changes in advances, assets, capital, and net income of the twelve FHLBanks during the past twelve months. It is quite apparent that asset changes and the accompanying revenue reductions have not been evenly felt by the individual Banks. The changes reflect both the economic variations within the twelve FHLBank Districts and the differential impact which FIRREA has on the FHLBanks.

The initial \$1 billion of retained earnings transfers were based upon ratios which were not related directly to the assets or net income of the individual FHLBanks, but were more closely related to the share of SAIF insured member assets. All required levels of transfers after the initial \$1 billion are based upon SAIF insured member assets. When the ratio of advances and earning assets held by individual FHLBanks is less than the ratio of member assets in their District, that District Bank has typically suffered a greater proportional loss of retained earnings. Currently, four of the FHLBanks are "deficient" for dividend purposes because the allocation to them exceeded their available

retained earnings.

Two other factors reflecting any uneven effects between FHLBanks relate to the ability of the RTC to address insolvent institutions within each District, and the regional economic conditions which determine the overall demand for advances within that District. These are clearly beyond the control of the individual FHLBanks and are not related to the direct effect of FIRREA on the FHLBank System. One other factor which does have an influence on individual FHLBank earnings is the ratio of non-SAIF insured members within a District. Those Banks which have historically had more non-SAIF insured members have suffered the least in terms of income and asset reductions. The issue of the ability to expand membership to newly eligible institutions is of prime importance to each FHLBank within the System.

One other question which was raised in the invitation was whether the number of District Banks should be altered. This is an issue which is strictly the province of the Federal Housing Finance Board. My personal opinion is that some of the judgments which have been expressed about reducing the number and functions of the FHLBank System are premature. We are in a period of transition. One aspect of that change is a significant restructuring of the programs

and costs within each FHLBank. We are studying the potential for efficiency improvements through combining some of our support and service functions. I know that every FHLBank is intently reviewing all of its activities to insure that no unnecessary costs remain. As was reported in our testimony last year, even the most optimistic appraisal of these efforts is not consistent with significant additional net income. The FHLBank System operating cost ratio is an extremely low .17% of assets. When allowance is made for the self-supporting service functions, that ratio falls by over one-half. If significant additional net income is to be found, it can only come from expanded membership.

The issue of changes in the number and geographical composition of the Banks is another decision that may be better served after a year or two of the transition is complete. With some change in the conditions for membership and time for the current program of outreach to gain success, the present patterns of membership could be substantially changed and the total number of members substantially increased. The FHLBank System has been a very successful financial institution throughout its history because it has had a clear focus on its function and has been well managed. A part of any reasonable plan is sufficient time for those responsible to effect adjustments

to new conditions. Despite the sense of urgency suggested by some, it may be another year or two before an answer to this issue can come into clearer focus. Those actions needed to make the necessary adjustments are being made.

Conclusion

In conclusion, on behalf of myself and the Presidents of the Federal Home Loan Banks, I would like to thank you for this opportunity to testify about the structure, accomplishments, and prospects of the Federal Home Loan Bank System. The FHLBank System has a long standing record of financial strength and significant accomplishments in obtaining the policy objectives placed before it. The FHLBank System has maintained this record without loss, without cost to the taxpayer, and without posing a potential threat of expense now or in the future to the Treasury. I am proud of the accomplishments of the FHLBank System. With some adjustments to the requirements for membership and the ability of all eligible institutions to utilize FHLBank System funding in proportion to their commitment to housing, that record of success will be continued and enhanced.

Thank you for the opportunity to appear before you. We will be pleased to answer any questions.

**FHLB SYSTEM
SELECTED BALANCE SHEET ITEMS
AS OF AUGUST, 1990 AND JULY, 1989
(\$ IN MILLIONS)**

	AUG 1990	JUL 1989	CHANGE
TOTAL ASSETS	\$160,386	\$193,579	-17.15%
TOTAL ADVANCES	121,988	159,651	-23.59%
CAPITAL STOCK OUTSTANDING	11,184	13,582	-17.66%
RETAINED EARNINGS	582	3,207	-81.85%

**FHLB SYSTEM
FINANCIAL HIGHLIGHTS
AS OF AUGUST, 1990 AND JULY, 1989
(\$ IN MILLIONS)**

	AUG 1990	JUL 1989	CHANGE
ADVANCES	\$121,988	\$159,651	-23.59%
INVESTMENTS	34,674	29,591	17.18%
CAPITAL STOCK	11,184	13,582	-17.66%
RETAINED EARNINGS	582	3,207	-81.85%
TOTAL CAPITAL	11,766	16,187	-27.31%
CAPITAL/ASSETS	7.30%	8.40%	
RETURN ON EQUITY	11.89%	12.34%	

**FHLB SYSTEM
SELECTED INCOME HIGHLIGHTS
FOR THE EIGHT MONTHS ENDED
AUGUST 31, 1990 AND AUGUST 31, 1989
(\$ IN MILLIONS)**

	1990	1989	CHANGE
NET INCOME	\$999	\$1,308	-23.62%
TOTAL REVENUE	10,053	11,640	-13.63%
RETURN ON ASSETS	0.89%	1.04%	-14.42%
RETURN ON EQUITY	11.89%	12.25%	-2.94%
DIVIDEND RATE	9.08%	11.33%	-19.86%

NOTES:

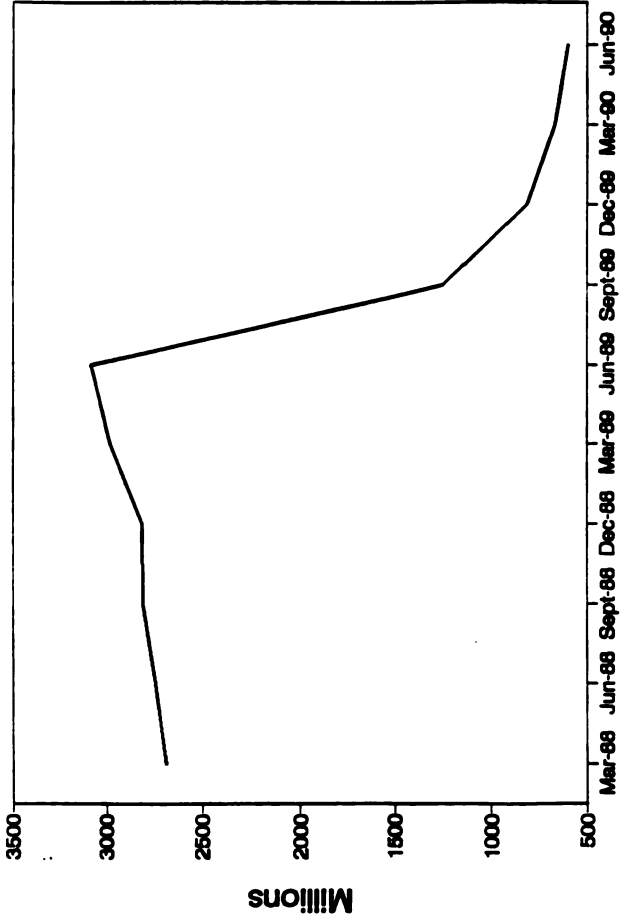
Return on assets and return on equity are annualized figures.

Dividend figures are for the third quarter.

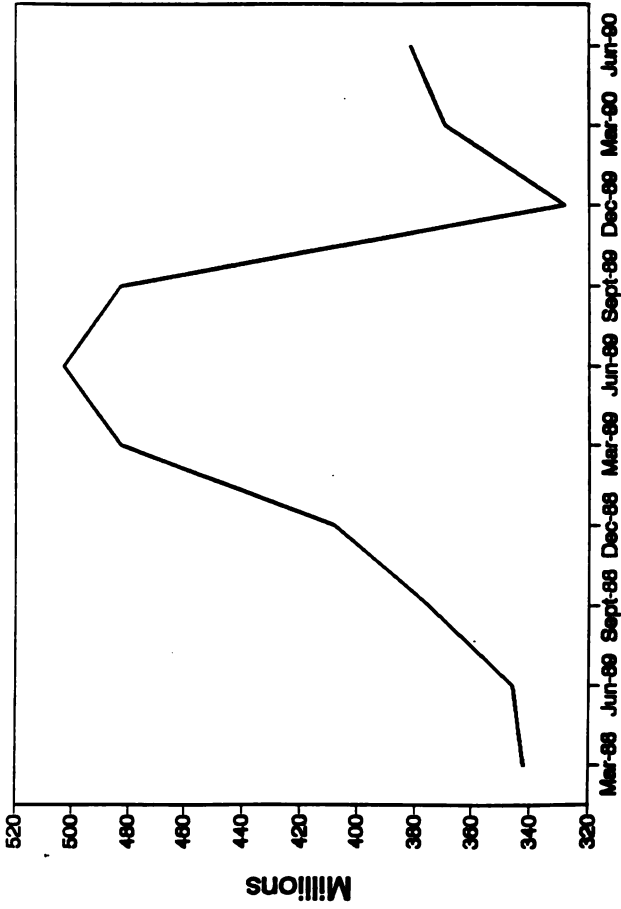
FHLB SYSTEM
PERCENTAGE CHANGES IN SELECTED FINANCIAL DATA
FOR ONE YEAR PERIOD ENDING AUGUST, 1990

BANK	ADVANCES	TOTAL ASSETS	RETAINED EARNINGS	TOTAL CAPITAL	NET INCOME
Boston	(16.8)%	(7.8)%	(79.9)%	(11.9)%	(8.4)%
New York	(8.2)	(5.6)	(87.4)	(20.4)	(19.5)
Pittsburgh	(33.2)	(10.0)	(84.7)	(43.7)	(39.4)
Atlanta	(25.9)	(17.3)	(87.0)	(24.8)	(17.4)
Cincinnati	(32.5)	(22.1)	(90.3)	(28.6)	(32.1)
Indianapolis	(11.7)	(97.0)	(71.2)	(25.9)	(21.3)
Chicago	(23.6)	14.3	(88.7)	(23.8)	(20.8)
Des Moines	(49.3)	(23.3)	(77.4)	(35.0)	(38.7)
Dallas	(38.3)	(38.8)	(80.7)	(50.9)	(46.2)
Tampa	(37.0)	(22.5)	(81.9)	(31.4)	(14.9)
San Francisco	(8.0)	(10.4)	(82.0)	(20.0)	(20.0)
Seattle	(23.7)	(12.6)	(69.0)	(20.1)	6.4
System	(22.0)%	(16.4)%	(82.6)%	(27.9)%	(23.6)%

March 1988 Through June 1990



FHLB System Quarterly Net Income March 1988 Through June 1990





NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS
P.O. Box 3769 WASHINGTON, DC 20007
(703) 522-4770

TESTIMONY OF ADMIRAL THOMAS J. HUGHES

EXECUTIVE COMMITTEE MEMBER (TREASURER)

THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

AND

PRESIDENT/CEO OF NAVY FEDERAL CREDIT UNION

**BEFORE THE SUBCOMMITTEE ON GENERAL
OVERSIGHT AND INVESTIGATIONS**

**COMMITTEE ON BANKING, FINANCE AND
URBAN AFFAIRS**

OF THE

UNITED STATES HOUSE OF REPRESENTATIVES

October 10, 1990

Good afternoon, Mr. Chairman and distinguished members of the subcommittee. My name is Thomas J. Hughes, and I am an elected member of the Executive Committee of the National Association of Federal Credit Unions (NAFCU). NAFCU is the only national organization exclusively representing the interests of credit unions chartered by the federal government, all of which are required by law to be federally insured. There are 8,675 federal credit unions nationwide. I also serve as President and Chief Executive Officer of Navy Federal Credit Union, which provides low-cost financial services to more than one million individual members.

I am pleased to have this opportunity to testify before you today on whether credit unions are finding Federal Home Loan Bank (FHLB) membership an attractive option. As you know, provisions contained in Title VII of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) -- Public Law 101-73 - - expanded the eligibility criteria for membership in the Federal Home Loan Banks to include both federally insured commercial banks and federally insured credit unions.

Mr. Chairman, on October 13, 1989 NAFCU's Chairman, John Stanton, submitted written testimony to your subcommittee in response to your invitation to testify at hearings you called on this same matter last year. At that time, we indicated our belief that the Federal Home Loan Bank system could serve as an alternative liquidity source for credit unions. Since that time, NAFCU has taken many steps to inform and educate our member credit unions concerning the merits of Federal Home Loan Bank membership as a viable alternative for credit unions.

NAFCU believes that as a trade association in our nation's capital representing federal credit unions from throughout the country, we have an affirmative obligation to present their views before Congress, the Administration and the various regulators. But NAFCU's responsibility goes beyond that. We also believe NAFCU has an affirmative obligation to provide reliable information to credit unions about what powers and authorities Congress and the regulators have bestowed on

credit unions. Clearly, this includes the authority bestowed upon credit unions last year to access the resources of the Federal Home Loan Bank system.

In pursuit of the goal and in fulfillment of that obligation, the National Association of Federal Credit Unions has taken a number of positive steps over the course of the past twelve months. These have included:

- * inviting senior officials from two Federal Home Loan Banks to speak at NAFCU's Chief Executive Officers (CEOs) Conference last February;
- * inviting former Federal Home Loan Bank Board Chairman M. Danny Wall to address NAFCU's Congressional Caucus last March;
- * meeting with senior officials from a third Federal Home Loan Bank at our headquarters office to exchange and share information about our respective operations;
- * inviting senior officials from various Federal Home Loan Banks to exhibit at NAFCU's Annual Conference and to address delegates; and,
- * writing an educational article for our member

credit unions on the Federal Home Loan Banks for publication in our widely circulated magazine, the Federal Credit Union.

In addition, we at Navy Federal Credit Union participated in a meeting with senior officials from the Federal Home Loan Bank of Atlanta. We believe -- and the record confirms -- that NAFCU has gone to great lengths to meet its obligation to inform our member credit unions about the Federal Home Loan Bank alternative. However, in the process of educating our member credit unions of the opportunities available to them through Federal Home Loan Bank membership, NAFCU neither advocates nor discourages credit union membership. As is generally the case with other credit union operational matters, NAFCU believes that the ultimate decision to utilize the services of Federal Home Loan Banks or not to do so is properly a management decision arrived at by the elected volunteer leadership of individual credit unions, and their respective professional management teams, motivated by a desire to most properly meet the needs of their particular credit union's unique field of membership.

We believe that NAFCU has done an exemplary job of meeting its obligation to inform our credit union membership concerning the benefits of Federal Home Loan Bank membership. The NAFCU staff has researched the current condition of the Federal Home Loan Banks, the services they have to offer, and the cost of membership. Our research indicates that generally the Federal Home Loan Banks are operating soundly. We are concerned, however, that their ability to continue to operate soundly is largely contingent upon whether they will have to bear additional thrift bail-out costs and whether state-chartered thrifts will be able to exit the system at will. Perhaps the continued existence of the Federal Home Loan Bank structure has an element of doubt to it, given the pending taxpayer liability for savings and loan failures. These are important policy questions which doubtlessly will be reviewed and decided by the Congress.

While we understand that a number of credit unions are currently exploring the benefits of Federal Home Loan Bank membership, and some applications for membership are

pending, it is our understanding that, to date, no credit unions have been accepted for Federal Home Loan Bank membership. According to recent news articles, at least eight Federal Home Loan Banks have reported that credit unions have expressed an interest in joining the system. I think it is fair to conclude, based on the experience of the past year, that it is unlikely that there will be a significant number of credit unions joining the Federal Home Loan Banks in the near future. That does not necessarily mean, however, that the Federal Home Loan Banks are not suitable alternatives for selected credit unions. Indeed, the Federal Home Loan Banks can be an alternative source of long-term lending for housing in certain markets. While we still do not recommend that credit unions join the Federal Home Loan Banks, we have no objection to the option to join the Federal Home Loan Banks being maintained.

To make the option of Federal Home Loan Bank membership more attractive to credit unions, serious consideration should be given towards reducing the stock purchase requirement for credit unions and allowing

withdrawal to be easier and quicker. For many credit unions the minimum stock purchase requirement is prohibitive and biased. NCUA guidelines for credit union mortgage lending discourage credit unions from placing excessive portions of their lending portfolios in mortgages principally because of the long-range nature of the investment and the interest rate risk prevalent in our economy these past recent years. NCUA sets 25 percent of assets as the guideline ceiling at which point examiners are required to review carefully the fiscal wisdom of such long-range risks. Yet the stock purchase requirement for credit unions in the Federal Home Loan Banks requires a minimum investment of 1%, based on a floor of 30% of assets being in mortgages. In the case of Navy Federal Credit Union, this would amount to over \$12 million, whereas other members with our mortgage portfolio would only be required to purchase about \$8 million in Federal Home Loan Bank stock. The philosophical dichotomy of pushing mortgages on the one hand and trying to limit long-range investments on the other creates a dilemma for credit unions. We honestly believe that meeting significant and important national

housing goals could be abetted by reducing the stock purchase requirement. Reduction of the stock purchase requirement could also have the ancillary benefit of increasing membership in the Federal Home Loan Bank System.

As I stated at the beginning, membership in the Federal Home Loan Banks by credit unions would provide an alternate source of liquidity. However, in today's climate, credit unions are amply liquid and do not have a large need for such resources. As our fiscal environment changes, such an availability may well be sought after and welcomed.

Once again, thank you for giving the National Association of Federal Credit Unions (NAFCU) the opportunity to testify on this important issue. Mr. Chairman, I would be happy to respond to any questions you or your colleagues might have.

BIOGRAPHY OF VICE ADMIRAL THOMAS J. HUGHES, USN (Ret.)

Vice Admiral Thomas J. Hughes was born in Brooklyn, New York, on October 14, 1926. He attended St. Teresa's Grammar School and Boys' High School before enlisting in the Navy in December 1943. After attending Williams College and Franklin and Marshall College VADM Hughes transferred to the active NROTC at Harvard University, where he received a B.S. Degree and was commissioned on June 6, 1946.

Vice Admiral Hughes served as a Junior Officer on Destroyers, Amphibious and Service Force ships. He attended the Armed Forces Staff College and the Operations Analysis curriculum at the U.S. Naval Postgraduate School where he received a Master of Science Degree.

In 1962, VADM Hughes was assigned to the Organization of the Joint Chiefs of Staff followed by command of a guided missile destroyer, USS JOHN KING. He commanded amphibious cargo ship USS THUBAN and assumed command of oiler USS CHIKASKIA in November 1967. In September 1971 VADM Hughes became Commander Destroyer Squadron THIRTY-SIX and served as the Gunline Commander off South Vietnam. VADM Hughes assumed duty as Assistant Chief of Naval Personnel for Financial Management and Management Information During this tour, he was a member and then elected as President of the Board of Directors of Navy Federal Credit Union; he also served as a member of the Board of Directors of the Navy Mutual Aid Association. He assumed command of Service Group TWO in September 1976. In October 1978 he became Deputy, and later, Director, Budget and Reports in the Office of the Navy Comptroller. In June 1981, he became Assistant Deputy Chief of Naval Operations (Manpower, Personnel and Training). In June 1983, he was assigned as the Deputy Chief of Naval Operations (Logistics).

On 1 August 1987, after 43 years of active service (41 years commissioned), VADM Hughes retired and became President, Navy Federal Credit Union. He is a member of Sigma XI and is on the Board of Directors of the National Association of Federal Credit Unions. He has served on the Credit Union National Association's Committee on Credit Union Uniqueness and Philosophy and the Reserves Study Commission. He is currently a member of CUNA's Deposit Insurance Study Task Force and is also a member of the Research Council of the Filene Research Institute.

VADM Hughes and Mrs. Hazel (Koblitz) Hughes (of Sterling, Kansas) reside at 4303 Middle Ridge Drive, Fairfax, Virginia 22033.

9/10/90

Statement of
Edward L. Yingling
Executive Director of Government Relations

on behalf of the
American Bankers Association

Before the

Subcommittee on General Oversight and Investigations
Committee on Banking, Finance and Urban Affairs
House of Representatives

October 10, 1990

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I. Introduction

Mr. Chairman and Members of the General Oversight and Investigations Subcommittee, my name is Edward L. Yingling, and I am Executive Director of Government Relations for the American Bankers Association (ABA). I appreciate the opportunity to appear before the Subcommittee this afternoon to comment on behalf of the ABA on commercial bank participation in the Federal Home Loan Bank System. The American Bankers Association represents all segments of the U.S. commercial banking industry. Eighty-five percent of our members have less than \$100 million in assets, and the combined assets of our members comprise about 95 percent of the industry.

The banking industry has a tremendous and growing interest in the mortgage markets. In fact, the U.S. commercial banking industry now extends more residential mortgage credit than any other industry, including the thrift industry. For this reason, the role of banks in the Federal Home Loan Bank System is critically important.

The issues you have identified, Mr. Chairman, bear directly on the structure and continued existence of the Federal Home Loan Bank System. It is important and timely that these issues are reviewed. The ABA commends you, Mr. Chairman, for holding this follow-up hearing.

As you know, Mr. Chairman, FIRREA narrowed the focus of the Home Loan Bank System to providing a broader source of funding -- both short- and long-term -- for

residential mortgages. Membership in the System, previously restricted to only savings and loan associations, was expanded to allow banks and credit unions to join. This action was designed not only to bolster the capital base of the system (which in part was dedicated to financing a portion of the cost of resolving the FSLIC's insolvency) but, more importantly, to further the social objective of ensuring that a stable source of mortgage credit is available to home buyers at reasonable prices.

Unfortunately, the structure of the system has discouraged participation by banks. In fact, as of last week only 24 banks have become members -- out of an estimated 7,300 that qualify for membership. Clearly, the salutary goals envisioned in expanding Federal Home Loan Bank membership have not been met. The following changes would result in greater participation by banks:

- (1) elimination of the minimum ratio of mortgages to assets necessary to qualify for membership;
- (2) elimination of the differential requirement between thrifts and banks for purchasing Federal Home Loan Bank stock; and
- (3) elimination of the limit on the total amount of advances that can be issued to banks.

There are, as you well know, some more fundamental questions about the Home Loan Banks' financing and, indeed, the future role of the Federal Home Loan Bank System. These questions will need to be resolved in the long run, and undoubtedly the uncertainty about the eventual answers to these questions is having a chilling effect on commercial banks' participation.

II. The Minimum Ratio of Mortgages to Assets Necessary to Qualify for Federal Home Loan Bank Membership

Under FIRREA, a bank may become a member of a Federal Home Loan Bank only if it has at least 10 percent of its total assets in residential mortgage loans. The rationale for this provision was that Federal Home Loan Bank membership should be limited to those institutions with a commitment to mortgage lending. The volume of mortgage lending relative to assets, however, has little to do with the commitment of a bank to make residential mortgages. In fact, many mid-sized and large banks have very large dollar commitments to residential real estate, but these commitments do not exceed 10 percent of their assets. For example, a bank with just over \$5 billion in assets could have \$500 million in residential mortgage loans and not qualify for Home Loan Bank membership. As of year-end 1989, commercial banks that would *not* meet the 10 percent mortgage-to-asset criteria held \$93 billion in residential mortgages. There are 5,000 banks making this

considerable commitment to home lending which are prevented from becoming members of the Federal Home Loan Bank System.

Mr. Chairman, some have argued that limiting access to only those institutions with high proportions of their assets in mortgages assures that these advances will be used for housing and not other types of lending. However, the collateral requirements for advances were tightened considerably in FIRREA: advances must be fully secured by whole first mortgages in residential property; securities issued, insured or guaranteed by the U.S. government or any agency thereof (including securities issued by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association and the Government National Mortgage Association); deposits of a Federal Home Loan Bank; or other real estate collateral acceptable to the Federal Home Loan Bank. Such collateral requirements help ensure that the advances will be used to fund residential mortgages.

The primary purpose of Federal Home Loan Bank membership is to encourage greater participation and commitment to residential mortgage lending. It is clearly counter to good public policy to reward only those financial institutions that meet some arbitrary level of participation. Rather, the proper policy should encourage greater participation by *all* mortgage lenders regardless of their level of residential mortgages.

Eliminating this arbitrary constraint will be a strong boost to greater participation in the Home Loan Bank System by commercial banks.

III. The Differential Requirement Between S&Ls and Banks for Purchasing Federal Home Loan Bank Stock

Membership in the Federal Home Loan Bank System and access to advances requires purchases of Home Loan Bank stock. Thrifts (meeting the qualified thrift lender test) are required to purchase stock in the regional Home Loan Bank equal to one percent of the thrift's mortgage assets or 5 percent of advances, whichever is greater. For banks, the stock purchase requirements for membership and advances are more stringent. They must purchase stock equal to the greater of three measures: (1) one percent of mortgage assets; (2) 0.3 percent of total bank assets; or (3) five percent of advances divided by the percent of actual thrift investment percentage. The second and third measures are the ones that inhibit banks from being members of a Home Loan Bank.

Let me give some examples of how these requirements discourage bank participation. Take a \$1 billion bank that holds 10 percent of its assets in mortgage loans. At that level, the bank meets the current minimum requirement to join a Home Loan Bank. Under the first stock purchase requirement, the bank would have to obtain stock equal to \$1 million (i.e., 1 percent of \$100 million). However, under the second condition, the bank would have to pay much more: \$3 million (i.e., 0.3 percent of \$1 billion). Thus, this bank must buy stock *as if it had 30 percent of its assets in mortgages*.

The immediate result of this is that only those institutions with over 30 percent of their assets in home mortgages may be interested in joining a Home Loan Bank. Of the 7,300 banks that would currently qualify to join, only 800 or so are not inhibited by the 0.3 percent of total asset test.

The third stock purchase requirement can even be more onerous than the second. If, for example, one assumes the \$1 billion bank has a 10 percent actual thrift investment percentage, the bank would be obligated to buy 50 cents worth of stock for every \$1 of advance it obtained (i.e., 5 percent divided by 10 percent actual thrift investment percentage).

Clearly, these requirements for stock ownership are such a burden that few banks are willing to participate. Only for those banks with a high proportion of mortgages in their portfolio is the stock ownership constraint less onerous. And as noted above, the proportion of mortgages in a portfolio is not an appropriate gauge of the commitment to mortgage lending.

The answer to this problem is clear: reduce the amount of stock required for membership.

IV. The Limit on the Total Amount of Advances That Can Be Issued to Banks

FIRREA permits each Home Loan Bank to lend a maximum of 30 percent of total advances to non-thrift lenders. This means that, in total, non-thrift mortgage lenders would have access to \$40 billion of the \$121 billion in advances made as of the end of August. While this share appears large, the 7,300 banks that currently qualify for Federal Home Loan System membership hold over \$250 billion in residential mortgages. Moreover, consider a Home Loan Bank region where the total advances to non-thrift lenders has reached the maximum 30 percent. No additional advances can be extended to non-thrift lenders even though advances could be used by these lenders to satisfy additional community needs for housing finance. At a time when banks are picking up the slack in home lending resulting from the shrinkage of the thrift industry, and given the decline in the size of the Home Loan Bank System, such a restriction seems particularly inappropriate.

V. Concerns about the Financial Structure of the Federal Home Loan Bank System

Another factor inhibiting bank participation is concerns over the ability of the Home Loan Banks to meet their obligations to help finance the FSLIC's insolvency, yet at the same time provide advances and pay dividends on stock at attractive rates. Currently, the Home Loan Banks must make annual contributions to the Resolution Funding Corporation of \$300 million. In addition, the Home Loan Banks must collectively contribute to the

Affordable Housing Program a sum of \$50 million. This contribution increases to \$75 million in 1994 and \$100 million in 1995. These obligations are fixed by statute.

Meeting these obligations may become increasingly difficult if the Federal Home Loan Bank System continues to contract. Since FIRREA was signed into law last year, the advances held by Home Loan Banks declined 22 percent. Thus, the fixed obligation comes out of a smaller pool of earning assets. In addition, there is some fear that more of the capital or earnings of the Home Loan Banks will be tapped. This certainly affects the projected returns on Federal Home Loan Bank stock, making membership less attractive to commercial banks.

Of course, eliminating unnecessary impediments to bank participation in the Federal Home Loan Bank system will likely improve the financial structure of the system, making it easier to meet the obligations to the Resolution Funding Corporation and still make Federal Home Loan Bank stock an attractive investment.

VI. Other Issues With Respect to the Home Loan Bank System

The ABA would also recommend that Congress take a good look at the correspondent services that are provided by the Home Loan Banks. It appears that many Home Loan Banks have attempted to aggressively expand their correspondent services.

As you know, Mr. Chairman, Federal Reserve Banks also engage in services to their members. Thus, it is important to recognize that there may be a duplication of these types of services, many of which are also offered by the private sector. Moreover, Federal Reserve Banks are governed by specific pricing principles which were established in the Monetary Control Act of 1980. Among other things, Federal Reserve Banks must set prices for services on the basis of all direct and indirect costs actually incurred, including interest on items credited prior to actual collection, overhead, and an allocation of imputed costs, which takes into account the taxes that would have been paid and the return on capital that would have been provided had the services been furnished by a private business firm.

This is an area that needs to be looked at in the course of an overall review of the Federal Home Loan Bank System. Questions which need to be answered include: What should be the role of the Home Loan Banks in providing correspondent services? How does this affect the provision of correspondent services by private providers, including "bankers banks." How do the costs of providing these services compare to costs of private providers? To what extent are these services provided by Federal Reserve Banks?

One other issue that the ABA is concerned about is the extension of asset powers of Home Loan Banks beyond advances. Congressional review is needed as to the what other assets -- such as jumbo mortgage loans or interest-only and principle-only strips -- should Home Loan Banks be allowed to hold. There are already other governmental

agencies, such as Fannie Mae, in addition to the private market, that adequately serve these markets.

VII. Summary

These issues are part of the broader question of the role of the Federal Home Loan Bank System in our financial system. The massive changes taking place in the thrift industry, combined with the impact of FIRREA on the Home Loan Banks, have completely undermined the traditional role of the Federal Home Loan Bank System. The Congress, we believe, needs to take a careful look at what the role of the Home Loan Banks should be in the future.

You asked us, Mr. Chairman, to testify specifically on whether commercial banks are finding Federal Home Loan Bank membership an attractive option. The answer is generally no. Eliminating the arbitrary minimum level of mortgages-to-assets necessary for membership, the differential stock-purchase requirement, and the limit on advances to non-thrift lenders would go along way to encourage banks to join the system, although there are other fundamental longer-term questions which are also having a chilling impact.

Mr. Chairman, you and the Subcommittee are to be commended for your continuing oversight on this important issue. Thank you for your consideration of the views of the American Bankers Association.

STATEMENT OF ROBERT S. DUNCAN
ON BEHALF OF
THE U.S. LEAGUE OF SAVINGS INSTITUTIONS
BEFORE THE
SUBCOMMITTEE ON GENERAL OVERSIGHT AND INVESTIGATIONS
OF THE
BANKING, FINANCE AND URBAN AFFAIRS COMMITTEE
OF THE
HOUSE OF REPRESENTATIVES

OCTOBER 10, 1990

SUMMARY

The Federal Home Loan Bank System has been an exceedingly well run operation up to now but we have serious concerns as to its future. The System has been operated very conservatively, has never suffered a loss and is extremely well-capitalized compared to other government sponsored enterprises.

The government has now tapped the Bank System to help resolve failed thrifts and for an affordable housing program. Over the next 30 years, these assessments will drain the Bank System of at least \$15 billion. The System's income is also declining because of a dwindling demand for its services.

So far, however, the earning power of the Banks relative to their capital structure has held up fairly well. The problem will be if the shrinkage of the System continues. The annual toll imposed on the Banks by FIRREA is essentially a flat fee rather than tied to income. As the income of the Banks declines with the shrinkage in the Banks' assets, the FIRREA assessments will amount to a greater percentage of the Banks' net income.

We recommend to Congress that the tariffs for the Resolution Funding Corporation and for affordable housing be made a percentage of the Banks' income rather than being flat fees.

SAIF-insured savings institutions are required to hold capital stock in the Federal Home Loan Banks equal to the greater of 1% of their outstanding home mortgage investments or 5% of their outstanding borrowings from the System.

Forcing savings associations to belong to the Bank System has the anomalous result that the Bank System does not have real risk capital as that term is commonly understood.

We recommend that:

- ** Membership in the Bank System must be made voluntary for all institutions;**
- ** The Federal Home Loan Bank System must continue to be operated with minimal risk; and**
- ** While membership for SAIF-insured savings associations remains compulsory, pressures to ease FIRREA's entry requirements for commercial banks and credit unions should be resisted.**

Mr. Chairman and Members of the Subcommittee:

My name is Robert Duncan. I am chairman and chief executive officer of Magnolia Federal Bank for Savings, an \$800 million healthy savings institution in Hattiesburg, Mississippi. I am pleased to testify today representing the U.S. League of Savings Institutions.

I can summarize my statement succinctly by saying that the Federal Home Loan Bank System has been an exceedingly well run operation up to now but we have serious concerns as to its future.

Problems with farm credit, student loans, pensions and, most spectacularly, federal deposit insurance have heightened awareness of the federal government's huge contingent liabilities and the fact that those contingent claims have a nasty tendency to turn into claims in fact.

In the introduction to the U.S. government's budget earlier this year, OMB Director Richard Darman, in an attempt at humor unusual in such weighty government documents, talked of "hidden PACMEN"⁽¹⁾ in the budget, each "waiting to spring forward and consume another line of resource dots in the budget maze." Mr. Darman identified government sponsored entities (GSEs) among the PACMEN that "involve a risk of substantial future claims against the government."

With these concerns over GSEs, it is gratifying to report that the Federal Home Loan Bank System has been a paragon of low-risk, conservative operation during the almost sixty years of its existence. The twelve regional Banks, as the Treasury Department pointed out in its study of the GSEs, "have never suffered a loss on an advance."⁽²⁾ In today's troubled environment, this has to rank as an incomparable and unrivalled accomplishment.

(1) Budget of the United States Government, Fiscal Year 1991, pg. 15

(2) Report of the Secretary of the Treasury on Government Sponsored Enterprises, May 1990, pg. C-19.

Furthermore; as of the end of August 1990, the Banks had an admirable combined capital to assets ratio of 7.34% in contrast, for instance, to a comparable ratio, at the end of 1989, of 0.88% for Fannie Mae⁽³⁾ and 0.62% for Freddie Mac⁽⁴⁾.

THE BURDENS BEING PLACED ON THE BANK SYSTEM

Given the government's apprehension about its exposure from the credit budget, it is highly ironic that the first chinks appeared in the Banks' impressive structure only after the government itself started to drag the Bank System into the resolution process for failed and failing savings institutions. Consider the following:

1. In the Competitive Equality Banking Act of 1987, the System was tapped for funds to ensure the repayment of principal on the obligations issued by the Financing Corporation. To date, the System has been stripped of \$680 million for this purpose.
2. In the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the System's limited resources were attached in three ways:
 - a. It must provide funds to defease the principal on the Resolution Funding Corporation's obligations. Since the passage of FIRREA, the Bank System has given up \$2.1 billion for REFCORP funding. In total, the System will give up \$3.5 billion to ensure the principal repayment on FICO and REFCORP obligations. This represents an expropriation of the System's entire existing and a portion of its future retained earnings (\$300 million per year through 1991).
 - b. In addition, beginning in 1992, the System must hand over \$300 million of its earnings each year to help pay interest on the REFCORP bonds. This annual assessment will continue until the bonds are fully retired, sometime well into the 21st century.
 - c. The System is expected to provide funds for the Affordable Housing Program. For 1990, this contribution totaled \$79 million. By 1995, this program will garner the greater of \$100 million or 10% of the System's net income.

(3) Ibid., pg. A-84.

(4) Ibid., pg. B-70.

In short, over the next 30 years, the Bank System will be asked to contribute at least \$15 billion to FICO and REFCORP debt needs and to affordable housing.

THE FEDERAL HOME LOAN BANK SYSTEM TODAY

The problems in the savings and loan business have had a dramatic impact on the Federal Home Loan Bank System. As Table 1 shows, the Bank System is shrinking markedly.

Table 1: Total Assets of the Federal Home Loan Bank System
(Dollars in Millions)

<u>Bank District</u>	<u>August 1989</u>	<u>August 1990</u>	<u>Percent Change</u>
Boston	\$12,195	\$11,241	-7.82%
New York	\$18,539	\$17,499	-5.61%
Pittsburgh	\$6,847	\$6,161	-10.02%
Atlanta	\$24,496	\$20,267	-17.26%
Cincinnati	\$6,626	\$5,161	-22.11%
Indianapolis	\$8,078	\$7,511	-7.02%
Chicago	\$6,296	\$7,191	14.29%
Des Moines	\$7,304	\$5,602	-23.30%
Dallas	\$33,555	\$20,524	-38.83%
Topeka	\$10,989	\$8,512	-22.54%
San Francisco	\$46,109	\$41,323	-10.38%
Seattle	\$10,744	\$9,395	-12.56%
System	\$191,774	\$160,387	-16.37%

Source: Federal Housing Finance Board, U.S. League of Savings Institutions.

As can be seen clearly from these data, the Banks in those areas of the country with the most savings institution failures (Des Moines, Topeka and, particularly, Dallas) are generally the Banks that are shrinking most rapidly.

The Cincinnati Bank is an exception to that trend, with the Bank shrinking significantly although the district is not noted for the number of failures. This shows that there are reasons other than the failure of client institutions that account for the contraction of the FHL Banks: there is simply less demand for advances because institutions are downsizing to meet new and more stringent capital requirements or because demand for loans in the real estate sector has dried up.

As the Bank System's asset base shrinks so does its capital as is shown in Table 2.

Table 2: Total Capital of the Federal Home Loan Bank System
(Dollars in Millions)

<u>Bank District</u>	<u>August 1989</u>	<u>August 1990</u>	<u>Percent Change</u>
Boston	\$1,007	\$887	-11.92%
New York	\$1,783	\$1,421	-20.30%
Pittsburgh	\$706	\$398	-43.63%
Atlanta	\$1,981	\$1,490	-24.79%
Cincinnati	\$728	\$520	-28.57%
Indianapolis	\$675	\$500	-25.93%
Chicago	\$770	\$587	-23.77%
Des Moines	\$628	\$408	-35.03%
Dallas	\$2,541	\$1,249	-50.85%
Topeka	\$854	\$585	-31.50%
San Francisco	\$3,858	\$3,087	-19.98%
Seattle	\$793	\$634	-20.05%
System	\$16,324	\$11,766	-27.92%

Source: Federal Housing Finance Board, U.S. League of Savings Institutions.

Table 3: Total Capital of the Federal Home Loan Banks as a Percent of Assets

<u>Bank District</u>	<u>August 1989</u>	<u>August 1990</u>
Boston	8.26%	7.89%
New York	9.62%	8.12%
Pittsburgh	10.31%	6.46%
Atlanta	8.09%	7.35%
Cincinnati	10.99%	10.08%
Indianapolis	8.36%	6.66%
Chicago	12.24%	8.16%
Des Moines	8.60%	7.28%
Dallas	7.57%	6.09%
Topeka	7.77%	6.87%
San Francisco	8.37%	7.47%
Seattle	7.38%	6.75%
System	8.51%	7.34%

Source: Federal Housing Finance Board, U.S. League of Savings Institutions.

Since the total capital of the Banks fell by almost 28% while total assets declined by 16%, the capital-to-assets ratio necessarily had to decline as indeed is shown in Table 3.

What must be understood about the capital position of the Banks, however, is that the amount of capital stock held by member institutions has declined proportionately to the assets of the Bank System so that, as shown in Table 4, the capital-stock-to-total-assets ratio has held remarkably stable throughout this troubled period.

Only in the Pittsburgh and Chicago Banks has there been a significant decline in the capital stock ratio and these had more than average to start with.

Table 4: Capital Stock of the Federal Home Loan Banks as a Percent of Assets

Bank District	August 1989	August 1990
Boston	7.08%	7.61%
New York	8.03%	7.87%
Pittsburgh	8.37%	6.17%
Atlanta	6.65%	7.07%
Cincinnati	8.62%	9.69%
Indianapolis	6.47%	5.95%
Chicago	9.77%	7.83%
Des Moines	6.45%	6.48%
Dallas	6.59%	5.73%
Topeka	6.41%	6.48%
San Francisco	7.14%	7.17%
Seattle	5.89%	6.10%
System	7.08%	6.97%

Source: Federal Housing Finance Board, U.S. League of Savings Institutions.

What these numbers show is that the capital ratios of the Banks have declined because of the government's depredation of the retained earnings of the Banks rather than a drop of members' capital investment in the Banks that is anything more than proportional to the drop in the Banks' total assets. Between August 1989 and August 1990, the retained earnings of the Bank System plunged from \$2.7 billion to \$583 million, a drop of \$2.2 billion or 79%. Thus, almost the entire remaining capital base of the System – \$11.2 billion of the \$11.8 billion total – comes from the capital stock investment of member institutions.

The confiscation of the retained earnings is not the only negative impact of FIRREA on the Bank System. Each year, the Banks have to contribute at least \$350 million towards the resolution of failed thrifts and towards the affordable housing program. With these imposts and with the decline in the Banks' business,

net income for the first eight months of this year fell by \$300 million as is detailed in Table 5.

Table 5: Federal Home Loan Bank System Net Income
(Dollars in Millions)

Bank District	August 1989	August 1990	Percent Change
Boston	\$86.1	\$78.9	-8.36%
New York	\$120.7	\$97.1	-19.55%
Pittsburgh	\$61.2	\$37.2	-39.22%
Atlanta	\$151.3	\$125.0	-17.38%
Cincinnati	\$46.3	\$31.4	-32.18%
Indianapolis	\$58.3	\$45.9	-21.27%
Chicago	\$48.6	\$38.5	-20.78%
Des Moines	\$49.0	\$30.0	-38.78%
Dallas	\$203.0	\$109.2	-46.21%
Topeka	\$74.4	\$63.3	-14.92%
San Francisco	\$348.3	\$278.6	-20.01%
Seattle	\$60.3	\$64.2	-6.47%
System	\$1,307.5	\$999.3	-23.57%

Source: Federal Housing Finance Board, U.S. League of Savings Institutions.

Interestingly, the decline in the Banks' net income has been slightly less than the decline in the Banks' capital -- income fell by 23.6% while total capital fell by 27.9%. For that reason, the Banks' return on capital actually increased slightly between the first eight months of 1989 (12.01%) and the first eight months of 1990 (12.74%). And as is shown in Table 6, that pattern is remarkably consistent across each of the districts.

The return on equity performance of the Federal Home Loan Bank System is put in perspective in Table 7 which shows the Banks' ROE over the last three years as compared with the other large GSEs.

The fact that the Federal Home Loan Bank System is so out of line with the other GSEs is not because of any lack of earning capability relative to the other entities but because the Bank System has so much more capital than the other GSEs. In other words, the Bank System is out of step not because of low earnings but because of high capital. In contrast, Fannie Mae, Freddie Mac and Sallie Mae turn in such impressive return on equity numbers simply because their equity is so low.

Table 6: Federal Home Loan Bank System Return on Total Capital: First 8 Months 1989 and 1990 .

<u>Bank District</u>	<u>August 1989</u>	<u>August 1990</u>
Boston	12.83%	13.34%
New York	10.15%	10.25%
Pittsburgh	13.00%	14.02%
Atlanta	11.46%	12.58%
Cincinnati	9.54%	9.06%
Indianapolis	12.96%	13.77%
Chicago	9.47%	9.84%
Des Moines	11.70%	11.03%
Dallas	11.98%	13.11%
Topeka	13.07%	16.23%
San Francisco	13.54%	13.54%
Seattle	11.41%	15.19%
System	12.01%	12.74%

Source: Federal Housing Finance Board, U.S. League of Savings Institutions.

Table 7: Return on Equity of Various GSEs
(Average for 1987 through 1989)

Federal Home Loan Bank System	10.8%
Federal National Mortgage Association ⁽⁵⁾	26.9%
Federal Home Loan Mortgage Corporation ⁽⁵⁾	26.9%
Student Loan Marketing Association	28.4%

Source: "Government Sponsored Enterprises: The Government's Exposure to Risks," United States General Accounting Office, August 1990, Table 2.8, pg. 64.

Returning to the Bank System, the ROE for the System has risen from 1989 to 1990 because total capital has declined more than net income has. Net income thus amounts to a slightly larger percent of capital than before; return on equity has increased.

-
- (5) That the ROE for Fannie Mac and Freddie Mac over the last three years would not only be similar but exactly the same is startling. Is it mere coincidence or does it suggest oligopolistic behavior?

Although return on equity is the common measurement of performance used in financial analysis, it is misleading in the case of the FHLBanks and in their ability to pay dividends, in particular.

Remember that equity as a percent of assets has declined because the government took away most of the retained earnings rather than because of a decline in members' investment in the System.

Table 8: Federal Home Loan Bank System Return on Capital Stock: First 8 Months 1989 and 1990

<u>Bank District</u>	<u>August 1989</u>	<u>August 1990</u>
Boston	14.95%	13.83%
New York	12.16%	10.58%
Pittsburgh	16.02%	14.68%
Atlanta	13.93%	13.08%
Cincinnati	12.16%	9.42%
Indianapolis	16.72%	15.40%
Chicago	11.85%	10.26%
Des Moines	15.61%	12.40%
Dallas	13.77%	13.94%
Topeka	15.85%	17.20%
San Francisco	15.86%	10.54%
Seattle	14.29%	16.81%
System	14.45%	13.40%

Source: Federal Housing Finance Board, U.S. League of Savings Institutions.

What members/owners care about is not the return on total capital, not the return on equity, but rather the return on the investment they have made in the system, the return on capital stock. It is meaningful to use the return on capital stock as a performance measurement for the Federal Home Loan Bank System because the cumulative value of the shares is the same as the total in the capital stock accounts of the Banks⁽⁶⁾.

(6) This would not be a particularly meaningful performance measurement for other enterprises since the value of their shares changes all the time. For those entities, the share value assigned in the capital accounts would generally bear little relationship to what shareholders actually paid for the stock and thus the return on capital stock would not equal the shareholders' return on investment. This shows how strange the capitalization structure of the Bank System is.

As is detailed in Table 8, the return on the members' stock investment has declined between 1989 and 1990. The decline has been particularly severe in the largest Bank, the San Francisco Bank.

Still, the earning power of the Banks relative to their capital structure has held up fairly well. The problem will be if the shrinkage of the System continues. The annual toll imposed on the Banks by FIRREA is essentially a flat fee rather than tied to income. As the income of the Banks declines with the shrinkage in the Banks' assets, the FIRREA assessments will amount to a greater percentage of the Banks' net income.

We would strongly recommend to Congress that the tariffs for the Resolution Funding Corporation and for affordable housing be made a percentage of the Banks' income rather than being flat fees.

THE INEQUITY OF MANDATORY MEMBERSHIP IN THE FEDERAL HOME LOAN BANK SYSTEM

SAIF-insured savings institutions are required to hold capital stock in the Federal Home Loan Banks equal to the greater of 1% of their outstanding home mortgage investments or 5% of their outstanding borrowings from the System. They are required to buy this stock whether they use the System's services or not.

The 1%-of-mortgages stock purchase requirement means that those savings institutions most dedicated to providing home loans are the ones with the most Federal Home Loan Bank stock exposure.

The mandatory nature of savings institutions' investment in the Federal Home Loan Bank System leads to several anomalous results:

1. From the point of view of the savings institution, the stock of the Federal Home Loan Banks does not meet two crucial tests that make investors willing to hold equities:
 - ** Because it is legally forced to maintain a certain level of investment in the Banks' stock, the institution cannot sell the stock or otherwise get rid of it.
 - ** Any stock that it may be allowed to redeem will just yield the par value of \$100 per share. Thus, there is absolutely no potential

... appreciation in the value of the shares, the common reason for holding equity investments.

2. From their point of view, the Federal Home Loan Banks don't have permanent equity capital as such capital is usually understood.

As the government looks for ways to strengthen the nation's financial system, great emphasis is being placed on the role of capital. The requirement that financial institutions maintain adequate levels of capital is seen to produce two beneficial results:

- ** Capital acts as a buffer against loss that protects the government from having to honor its guarantee.
- ** To protect their investment, shareholders exercise discipline over any tendency on the part of management to take excessive risks.

Neither of these benefits accrue from the capital position of the Federal Home Loan Banks:

- a. Anywhere else in the economy, an investor would buy an equity security in the hope that the investment would increase in value but would be mindful of, and willing to undertake, the risk that the investment could be lost. If at any stage, the risk level becomes non-acceptable for the potential return, the investor could sell the stock.

This freedom to get into, and ability to get out of, the investment is not allowed to savings institutions. And since these institutions are already under strain, they cannot afford the loss of this investment. In short, the capital of the Bank System cannot be put at risk; it is not risk capital.

- b. Compulsory shareholders in the Federal Home Loan Banks have no particular leverage over the management of the Banks. How can these shareholders exercise discipline over the Banks' management if management knows that the shareholders are legally enjoined from selling their stock?
3. The most curious situation of all arises from the fact that while most members are compulsory stockholders, there are some, particularly in the

Northeast⁽⁷⁾, that enjoy voluntary membership and therefore voluntary stockholder status.

Because of concerns over the safety of the investment in the stock of the FHLBanks, we now have the ironic circumstance that some members that are required to belong to the System are trying to leave, while those that are free to leave are choosing to stay.

Thus, in the past few months, we have had the *cause celebre* of Wauwatosa Savings in Wisconsin, along with a few other institutions, making the argument that, as state-chartered institutions insured before a particular date, there is no legal requirement forcing them to remain as members of the FHLBanks.

In the meantime, in the Federal Home Loan Bank of Boston, where 75% of the members are voluntary, there has not been a single defection since the passage of FIRREA.

This conundrum is totally logical. Voluntary members know that if they see any undue threat to their investment in the stock of the Bank System, they will be able to redeem their stock and get out. With this escape hatch, these institutions are willing holders of the stock needed to gain access to the benefits that membership in the Banks offers. Compulsory members do not have that escape hatch and some have determined that the benefits of membership in the Bank System do not compensate for the danger to their capital of being required to hold FHLBank stock.

These peculiarities of the Federal Home Loan Bank System argue for the adoption of several policies:

A. VOLUNTARY MEMBERSHIP IN THE FEDERAL HOME LOAN BANK SYSTEM:

In order for the capital of the Bank System to fulfill its dual role as a cushion against potential losses and as a discipline on management, the holding of the stock of the FHLBanks has to be made voluntary.

(7) As of March 31, 1990, the FHLBanks had 3,164 members, all except 298 of which were SAIF-Insured savings institutions. Of the 298 exceptions, 265 were in the Boston and New York Bank Districts (225 in Boston and 40 in New York). Ibid., pg. C-12

Some would argue that making the stock voluntary would threaten the stability of the Bank System since institutions would then be free to leave, liquidating their stockholdings in the Banks.

The experience of the Boston and New York Bank Districts show that this is not so. The Banks can and do retain voluntary members.

Of course, voluntary members would have to be confident that there was not an undue risk of losing their investment. But this is the very essence of the discipline-role of capital -- assuring that capital is not subjected to undue risk.

In fact, those that maintain that making membership voluntary would destabilize the Banks are implicitly saying that there is something so distasteful and dangerous in being a member of the Bank System that it is only with the might of the law behind them that the Banks can compel institutions to join. The Boston and New York experience shows that this is simply not true and, in any case, it is surely not a position that any proponent of the Bank System would want to espouse.

B. THE FEDERAL HOME LOAN BANK SYSTEM MUST CONTINUE TO BE OPERATED WITH MINIMAL RISK:

Since savings institutions are captive stockholders of the Banks and since they cannot afford to lose their investment in the Banks' stock, the Banks have to continue to operate in the same conservative manner as they have in the past.

In recent months there have been suggestions that the FHLBanks find new areas of endeavor to help bolster their dividends, under pressure from the burdens of FIRREA or to help make up for the lost business from a shrinking clientele base. Thus, for instance, the Dallas FHLBank has suggested getting involved in loans to developers⁽⁸⁾ while the New York Bank floated the idea of investing in jumbo mortgage loans.

(8) The Dallas FHLB has proposed a new program that would allow it to participate in thrifts' loans to developers. The FHLB would then sell 90 percent of its participating interests in the loans to outside investors. This program could increase the Dallas FHLB's risk exposure because it would require the FHLB to evaluate and underwrite construction loans, which have inherently greater

Since savings institutions own the Banks' stock and, therefore, are recipients of the dividends the Banks pay on that stock, they are vitally interested in having that dividend as high as possible. Even more important than the amount of the dividend, however, is the integrity of the stock itself.

If the stock were tradable or its holding otherwise optional and a Bank decided to engage in some risky activity, a particular savings institution that was alarmed at the activity and at the derivative risk would have the option of selling the stock, thereby avoiding the risk to its net worth.

With today's mandatory membership, however, the institution does not have that choice.

Even worse, though the Bank System is made up of twelve separate Banks, all are linked through the umbilical cord of joint liability. Thus, the savings institution that is a mandatory member is forcibly subject to risky activities of not only its local Bank but of every other Bank in the System also.

In short, the ability of the Banks to engage in new activities should be rigorously circumscribed. The crash of the FSLIC has luridly demonstrated the dangers of institutions trying to grow their way out of their problems by engaging in new activities. The remaining healthy savings institutions, having resisted the temptation to take that course as principals, do not need agents, to whom they are forcibly linked, to do it for them.

C. PRESSURES TO EASE THE ENTRY REQUIREMENTS FOR COMMERCIAL BANKS AND CREDIT UNIONS SHOULD BE RESISTED:

FIRREA opened up membership in the Federal Home Loan Bank System to commercial banks and credit unions. If a bank or credit union joins the FHLBank System, it is required to purchase stock in the System according to a complicated formula that in essence requires the purchase of stock equal to the greater of 0.3% of assets, 1% of mortgages or 5% of advances. The stock requirements mandated for banks and credit unions was an effort to make

credit risks than mortgages." "Government Sponsored Enterprises: The Government's Exposure to Risks," United States General Accounting Office, August 1990, pg. 58.

the stock purchase requirement for these new entrants at least somewhat comparable with those for savings institutions⁽⁹⁾.

Barely a year after the passage of FIRREA, certain Federal Home Loan Bank interests are seeking the virtual elimination of those requirements. We categorically oppose this initiative.

On October 1, the U.S. League wrote to Banking Committee Chairman Gonzalez expressing its opposition (see attached). We objected, on procedural grounds, that a question that raises so many complex issues should not be adopted within the context of a conference on a housing bill without the benefit of hearings.

While the Bank System is under some pressure, the analysis provided in this testimony shows that there is no reason for the panicky move of markedly changing new entrants' stock requirements without thorough hearings by the appropriate committees of Congress.

We also objected to the inequitable nature of a measure that would reduce the stock purchase requirements for favored voluntary members even further while continuing to hold our institutions hostage.

Finally, we pointed out that lowering the already low QTL threshold for membership for these new entrants was antithetical to the housing mission of the Federal Home Loan Bank System.

As well as seeking a change in the entry requirements for banks and credit unions, we have heard rumors that some in the Bank System are trying to gain access to the Banks for mortgage bankers. We would strenuously object to admitting such non-portfolio lenders to the Bank System.

Mr. Chairman, as I have said, we do not believe that FHLBank membership eligibility requirements should be changed without a thorough inquiry by Congress. In that regard, let me finish by congratulating you for the timeliness of the current hearing. I will be glad to answer any questions you or any members of the Subcommittee may have.

(9) The stock purchase requirement will never be fully comparable, of course, as long as savings associations are required to be members and purchase stock in the System while entry for the new constituency remains voluntary.


UNITED STATES LEAGUE of SAVINGS INSTITUTIONS

 1700 NEW YORK AVENUE, N.W. / WASHINGTON, D.C. 20008 / TEL. (202) 637-8888 (DIRECT DIAL)
 (202) 637-8883 (TELECOPIER)

J. DENIS O'TOOLE
 Executive Vice President
 for Government Affairs/Operations

October 1, 1990

HAND DELIVERED

The Honorable Henry B. Gonzalez
 Chairman
 Committee on Banking, Finance and Urban Affairs
 U.S. House of Representatives
 B-303 Rayburn House Office Building
 Washington, D.C. 20515

Dear Mr. Chairman:

The U.S. League of Savings Institutions, on behalf of the 2,452 private sector thrifts in operation who are required by Federal statute and regulatory interpretation to be stockholders of the Federal Home Loan Bank System, wishes to express our strongest opposition to any legislative attempt to loosen the eligibility requirements for commercial banks or credit union membership in the Federal Home Loan Bank System as was agreed in last year's Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA).

The issue of changing the membership eligibility criteria for the FHLBank System was not discussed by either of the Housing Subcommittee during their consideration of their respective housing bills, and it would therefore seem that any attempt by the Conference Committee on the National Affordable Housing Act to amend Title VII of FIRREA would be a matter outside the scope of the conference on housing authorization legislation.

Secondly, as a matter of public policy given that the FIRREA legislation establishes the general principle that thrift regulations should be comparable to commercial bank regulation, we see no reason why in the matter of FHLBank membership the standard applied to credit unions and commercial banks should be less rigorous than the qualifications applied to SAIF-insured thrift associations. As you know, SAIF-insured thrift institutions are required by Federal law to purchase FHLBank stock equal to the greater of 1% of an institution's portfolio holdings or 5% of the funds advanced to it from its district bank. More onerously, SAIF-insured FHLBank stockholders do not have the option to reduce their stockholding below these statutory minimums, and must remain compulsory members of the FHLBank System, while banks and credit unions have the option to leave the System whenever the cost of membership exceeds its value. Since the clear intent of altering the eligibility requirements for commercial banks and credit unions is to significantly reduce their stock purchase requirements, the amendment under discussion violates FIRREA's principle of regulatory equity and discriminates against the economic interest of SAIF-insured members.

THE AMERICAN HOME: THE SAFEGUARD OF AMERICAN LIBERTIES

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There is no doubt in our mind that the stock purchase requirements of the FHLBank System are troublesome and in need of a legislative overhaul. The U.S. League believes that the only equitable approach to the stock purchase issue is either to require a class of institutions eligible for membership to have compulsory FHLBank stock ownership, or to develop a voluntary membership system patterned along the requirements for membership in the Federal Reserve System (i.e., all members would be required to purchase stock equal to 3% of capital with the right to voluntarily opt out of the System). Our preference is to work with the Congress and the FHLBank System for the creation of a voluntary system for all class of financial institutions, and it is this goal against which we shall measure any proposals to change eligibility criteria.

Since the issue of FHLBank eligibility requirements is not included in the syllabus of the Housing Conference, we do not have the benefit of discussing specific amendatory language. However, we have been told that the proponents of change are seeking to amend Sec 714 of FIRREA to attempt the following:

a) to reduce the amount of stock that a commercial bank or credit union would have to purchase in order to be eligible for membership in the FHLBank System; (b) to authorize mortgage banking companies to be eligible for membership in the System; and (c) to eliminate the 30 percent of bank advances limitation or loans to non-QTL members.

The U.S. League believes that the Bank System has a very important function to play as a lender for housing finance, and we believe it is important for the earnings of the FHLBank System to offer investors an economic yield at market rate and yet still provide the System with sufficient earnings to meet its funding requirements under FIRREA. However, neither the housing mission of the FHLBank System nor its fiscal responsibility is substantially advanced by the amendment under discussion.

The idea that letting commercial banks join the FHLBank System will provide more money for housing is undermined by the very nature of the amendment being advocated. Currently FIRREA imposes progressively larger stock purchase requirements on banks with lower QTL percentages. The effect of this policy is to encourage only those banks with high QTL ratios to join the system. In so doing, the law assures that the resources of the Home Loan Bank System will actually be used for housing.

The proposed amendment would remove these safeguards and allow any bank to join and borrow on the same terms as a savings association regardless of its QTL ratio. That is a grossly inefficient way of supporting housing finance. For example, allowing a commercial bank with a QTL ratio of 10 percent to

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borrow from the Bank System means that nine of every ten dollars advanced are diverted for other purposes, such as making loans to finance LBO's or third-world debt. The fact that the advance is secured by a mortgage loan is meaningless since money is a fungible commodity that can be used for any item on the asset side of the balance sheet.

Removing any QTL requirements for commercial banks also relegates savings associations to the status of second class citizens in the Home Loan Bank System which they have build with their own capital. For example, FIRREA provides that a savings association failing to meet the QTL test becomes ineligible for any new advances from its Home Loan Bank. In addition, it must repay all outstanding advances within three years if it fails to regain QTL status.

The other reason advanced for easing the terms of commercial bank membership is that the Bank system is shrinking and that it needs additional income to pay for all of the changes imposed by FIRREA including payments to REFCORP and for the Affordable Housing Program. The demand for Bank advances is declining because the thrift industry itself is shrinking as a result of FIRREA. However, no evidence has been presented to the Congress to show that the Bank system is incapable of meeting its financial responsibilities under FIRREA.

In conclusion, the U.S. League requests that conferees on the National Affordable Housing Act defer taking any action on the issue of FHLBank System membership in the context of the very important and necessary 1990 housing authorization bill. There is unquestionably a need for Congress in a deliberative way in the 102nd Congress to consider the best means of enhancing the attractiveness of the FHLBank System for all classes of financial institutions. But whatever action is recommended, it must be equitable and competitively neutral. For the long-term, the U.S. League and its member institution support the concept of a completely voluntary system. In line with FIRREA's direction toward comparability of regulation and capital standards between thrifts and commercial banks, we must insist that this principle also be applied to the membership of commercial banks and credit unions in the FHLBank System, a system whose capital base was built up over the years by the economic contribution of savings institution members. Since approximately one-third of the savings business capital is held in the form of FHLB stock, this issue is of great significance to all of our members because preserving our capital base is fundamental to the success of FIRREA and the economic survival of the thrift business.

Sincerely yours,

J. Denis O'Toole

J. Denis O'Toole

Testimony of
Gerry J. Pittenger
on behalf of the
National Council of Savings Institutions

before the

Subcommittee on General Oversight and Investigations
of the
Committee on Banking, Finance and Urban Affairs
U.S. House of Representatives

October 10, 1990

Mr. Chairman, on behalf of the National Council of Savings Institutions, I would like to thank you for the opportunity to appear before you today to present our concerns over the status and future direction of the Federal Home Loan Bank System. My name is Gerry J. Pittenger, and I am Chairman, President and Chief Executive Officer of Great Western Bank, a Savings Bank, in Bellevue, Washington. In addition, I am a member of the Executive Committee of the National Council of Savings Institutions.

The National Council represents approximately 400 community bankers nationwide, with about \$385 billion in assets. Our membership is comprised of BIF-insured savings banks, as well as SAIF-insured savings associations. The one thing that unites all of our members, regardless of charter or insurance, is the fact that they serve their community's financial needs, albeit in different ways. These needs include personal and commercial real estate lending, consumer lending, small business credit, and a full line of savings vehicles.

As a means of developing our positions and policies on the System, the National Council has established a Task Force to study the matter and make policy recommendations. The work of the Task Force, of which I am the Chairman, should be completed early next year, and we will be happy to send a copy of the final report to you, Mr. Chairman.

Before I begin the detailed text of my statement, I would like to mention that the National Council places tremendous importance on the future health of the Federal Home Loan Bank System (the System). Our goal is to assure the long-term viability of the System as a valuable tool in meeting the housing needs of the country. We represent two important constituencies of the System, customers and stockholders.

Mr. Chairman, the National Council appeared before you almost one year ago to the day to discuss the future of the Federal Home Loan Bank System in a world changed by the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA). The legislation affected the size, structure, capital position, and earnings potential of the System. In short, these changes call into question the viability of the System.

We expressed many of these concerns last October, and unfortunately we must report to you today, that our concerns were well founded. Some provisions in FIRREA have frankly not worked as intended, and we would hope that the Congress would revisit the provisions in FIRREA that have affected the FHLB System.

While I will go into these matters in greater detail later in my statement, I would like to briefly address the two

biggest problems spawned by FIRREA.

First, the significant fixed costs to the System to support the recapitalization of the insolvent Federal Savings and Loan Insurance Corporation coupled with the System-subsidized Affordable Housing Program will assume an ever-increasing share of a shrinking earnings base. At some time in the future, if the System continues to shrink, this fixed burden will become insupportable.

The other significant problem is the erosion of the System's capital base due to FIRREA's confiscation of retained earnings. While the System still has a strong capital to assets ratio of 7.3 percent, this is significantly less than it was before the passage of FIRREA. Moreover, the costs imposed on the System are likely to continue the capital erosion.

At a time when significant attention is being focused on the capital level of all government-sponsored enterprises (GSE's) such as the Federal Home Loan Bank System, this drop in capital should be disturbing. While the System is still very strong, as noted in a recent Treasury Department Study of all GSEs, this loss of capital places even more pressure on it to raise capital through retained earnings.

In order to assess the System it is important to review what FIRREA did to it. The Act separated the supervisory functions of the old FHLB System from the credit functions. The supervisory functions now reside in the Office of Thrift Supervision, which recently reduced the number of regional supervisory offices from twelve to five.

The credit functions are housed under the Federal Housing Finance Board (FHFB), a new agency created to oversee the System. This agency is supposed to be composed of a five-person board comprised of the Secretary of Housing and Urban Development (HUD) and four other citizens nominated by the President, with the advice and consent of the Senate.

Unfortunately, none of the Presidential appointees have been confirmed, since there is a long-standing disagreement between the Administration and the Congress over whether or not the terms of the FHFB members are full-time or part-time positions. We are concerned that the lack of a sitting Board with a strong Chairman to oversee the operations of the System has resulted in a lack of direction at a critical time.

FIRREA expanded membership in the FHLB System to include banks, credit unions, and any other insured depository institution or insurance company that makes a certain commitment to mortgage lending. A depository institution may become a member if it holds 10 percent of its total assets in residential mortgage loans and is financially sound. Each new member must hold a minimum amount of stock equal to the amount that would be

required if 30 percent of the institution's assets were mortgage loans. State-chartered savings banks that are not members of the System on the date of enactment will be eligible to join under the rules established by the Act for commercial banks and credit unions.

FIRREA also established greater penalties for leaving the System. It raised the length of time that an institution resigning from membership must wait before readmittance from five years to ten years.

The Act also placed a number of significant financial burdens on the System. The System was forced to use its accumulated retained earnings (minus those committed to FICO), as well as current retained earnings until the end of 1991, to purchase Resolution Funding Corporation (REFCORP) stock and provide for the defeasance of \$30 billion in REFCORP borrowing.

In addition, after 1991 \$300 million per year will be contributed to REFCORP to pay interest costs on the REFCORP borrowing. The distribution of the first \$1 billion of FHLB System contributions will be based on the same distribution formula as that contained in CEBA. The remaining contributions will be divided among the respective banks on the basis of each bank's pro rata share of deposits insured by the Savings Association Insurance Fund.

FIRREA also established a subsidized advance program to foster lending for low- and moderate-income housing at favorable rates. The subsidy in years 1990 through 1993 will be an amount equal to at least 5 percent of FHLB income in the preceding year, but not less than \$50 million per year. This year, the contribution was \$78 million, due to last year's strong earnings.

The affordable housing subsidy will rise to 6 percent of the preceding year's income or \$75 million in 1994, and 10 percent of the preceding year's income or \$100 million in 1995 and beyond. These contributions may be suspended in cases where they will cause financial instability to an individual bank.

OVERALL IMPACT

While it is impossible to determine the precise effect of these provisions on the profitability, the dividend stream, or the capitalization of the System, it is clear that the combined effect will be negative. Moreover, the effects are cumulative and will take four to five years to manifest themselves fully.

I would like to summarize the reduction in System earnings due to FIRREA. First, the loss of all current retained earnings and future retained earnings through 1991 will reduce the earning assets of the System by \$3 billion to \$3.5 billion. This will result in a loss of investment income (assuming a

modest 8 percent rate of return) of \$250 million to \$300 million per year. In addition to this investment loss, beginning in 1992, another \$300 million will be diverted each year to REFCORP. Finally, the affordable housing program will cost at least another \$50 million in the years prior to 1993 and this cost will grow to \$100 million after 1995.

Thus, the total impact, once all the provisions are fully phased-in, will be \$600 million to \$700 million per year. Some of this increase--perhaps as much as \$160 million--will be offset by having the cost of the supervisory function shifted to the Office Of Thrift Supervision, but the net effect is still likely to be about \$450 million to \$500 million per year.

While these costs represent an amount equal to about one-third of FHLB 1988 earnings, the impact of these costs on future earnings and dividends will depend, of course, on the overall profitability of the System. As the System has grown rapidly in recent years, profitability has increased dramatically. The future, however, is far from certain. Government policy and changes in market factors such as the currently souring real estate markets, and/or the onset of a general recession could have a negative effect on the System.

One area in particular seems to suggest trouble for the System. The main source of revenue comes from the advances made to member institutions. Many of the more weakly capitalized institutions are disproportionately large users of the advance window. The capital provisions in FIRREA will force a significant shrinkage in the industry, especially among the weaker institutions. As these institutions leave the market, the main source of FHLB revenue will disappear. Indeed, a recent Treasury study correctly noted that, "The major business risk to the Bank System at this time is the declining demand for advances as a result of a contracting thrift industry."

The System Today

Currently there are 12 regional Home Loan Banks. As shown in Table 3, as of July 31, 1990, the 12 banks had total assets of \$160.2 billion, a drop of over 17 percent from the previous year. Advances made up over 76 percent of the assets in portfolio. These advances totaled \$122.5 billion, a drop of 23.3 percent from the earlier year.

While the System's capital has dropped almost 28 percent since the passage of FIRREA, the capital-to-assets ratio is still a strong 7.3 percent (down from 8.4 percent from July 31, 1989).

Advances are the primary vehicle used by the Federal Home Loan Banks to support housing finance, and they are the primary product and income producer of the banks. Advances are

funded by the issuance of consolidated obligations or debt instruments that are sold in the general credit markets. These obligations, while not backed by "the full faith and credit of the United States government," nevertheless carry "agency status" and therefore are issued at a very modest premium or spread over comparable maturity Treasury securities.

The strong capital position of the Federal Home Loan Banks has helped to keep the premium small. The subsidy provided by this agency status is passed on to savings institutions and, in turn, to the holders of home mortgages.

Clearly, the System has been an integral and successful component of the housing finance system in this country.

I would now like to specifically answer the questions you posed in your letter inviting the National Council to testify today.

1. Are commercial banks finding Federal Home Loan Bank membership an attractive option?

At this time only 27 new institutions have been admitted to the System, although 11 more applications are currently pending at the FHFB. As time passes, prospective members will be better able to assess the viability of the System and the benefits from membership. We would hope that they would elect to join the System. Of course, anything the Congress could do to remove the uncertainty concerning the System's future would go a long way towards encouraging membership.

The question of membership is vital to the future of the System. As the Treasury study on GSE's points out, "If, over the longer term, the Banks are to avoid shrinking along with the industry, the Bank System must replace failed thrifts and any voluntary members who withdraw."

Many of our BIF-insured members are voluntary members of the System, and, of course, our SAIF-insured institution members are required to be members of the System due to their federal charters. Our state chartered SAIF-insured members are awaiting a decision from the FDIC as to whether or not they may be allowed to exit the System.

This decision from the FDIC relates to a request by Wauwatosa Savings and Loan Association, a state-chartered SAIF institution in Wisconsin that has requested that the FDIC rule that membership in the System is not a necessary requirement for federal insurance. The FDIC has indicated that it will be rendering a decision on this question in the next eighteen months. Several other state-chartered savings institutions have also made similar applications.

Once again, if the Congress were to take action that

reduces the uncertainty facing the System, including reducing its burdens under FIRREA, then the concerns of the Federal Home Loan Bank members as to the viability of the System would be greatly reduced. Existing members would not be lead to exit the System and new members would be encouraged to join.

2. Should the number of Federal Home Loan Banks be altered?

The original act in 1932 provided for a varying member of banks between 8 and 12. Should a specific district see sufficient erosion in its membership to make it uneconomical to continue on as a separate bank, the remaining members could be incorporated into an adjoining district without a major disruption of credit flow.

A key player in any future decisions regarding shrinking the System would be the FHFB. It is therefore critical that the Board get up and running and that the delay in appointing its members come to an end.

CONCLUSION

In conclusion, the provisions of FIRREA have placed a heavy burden on the Federal Home Loan Bank System and in turn on the surviving savings institutions that are members of the System. We are skeptical that the inflow of new members will compensate fully for the loss in revenue. In any event, the capital of the System will be eroded, and the longer-term viability of the System will be called into question. We urge the Congress, in any future legislation, to be very careful to avoid placing any additional burden on the Federal Home Loan Bank System.

Mr. Chairman, the National Council will be prepared to submit an extensive list of policy recommendations to you upon the completion of the work of our Task Force on the Federal Home Loan Bank System. Clearly action must be taken to preserve the System, and you are to be applauded for holding this hearing. Thank you for the opportunity to testify, and I would be happy to answer any questions.

Table 1

**SELECTED BALANCE SHEET ITEMS
FOR THE FHLB SYSTEM
As of July 31
(\$ billions)**

	<u>1990</u>	<u>1989</u>	<u>1988</u>
Investments	33.5	29.6	17.8
Advances	122.5	159.7	135.8
Other Assets	4.2	4.3	4.2
Total Assets	160.2	193.6	157.8
Consolidated Obligations	119.7	151.5	119.4
Other Liabilities	28.7	25.9	23.6
Total Liabilities	148.4	177.4	143.0
Capital Stock	11.3	13.6	12.3
Retained Earnings	.5	3.2	2.8
FICO Distribution	—	.6	.3
Total Capital	11.7	16.2	14.8
Capital/Asset Ratio (Percent)	7.3	8.4	9.4

Percentage Change From The Preceding Year

	<u>1990</u>	<u>1989</u>	<u>1988</u>
Advances	-23.3	17.6	—
Total Assets	-17.3	22.7	—
Capital Stock	-16.9	10.6	—
Total Capital	-27.8	9.4	—

Totals may not add due to rounding.

Table 2

7
**SELECTED INCOME ITEMS
 FOR THE FHLB SYSTEM
 January - July
 (\$ millions)**

	1990	1989	1988
Income From Advances	6,856	8,633	6,528
Income From Investments	1,671	1,277	978
Other Interest Income	85	92	71
Total Interest Income	8,612	10,002	7,577
Interest Expense	7,732	8,696	6,696
Income From Prepayments	78	33	33
Other Non-Interest Income	146	94	153
Total Non-Interest Income	224	127	186
Total Non-Interest Expense	231	283	258
Net Income	872	1,150	810

Percentage Change From The Corresponding Period Of The Preceding Year

	1990	1989	1988
Income From Advances	-20.6	32.2	—
Income From Prepayments	136.4	0.0	—
Net Income	-24.2	42.0	—

Totals may not add due to rounding.

Table 3

SELECTED FINANCE SHEET ITEMS FOR REGIONAL FHB'S
(July 31, 1990 \$ Millions or Percent)

	BOSTON	NY	FTT	ATL	CINC	IND	CHI	DES	DAL	TP	SP	SEA
Total Assets	11,506	17,476	6,054	20,005	5,065	7,469	7,092	6,151	21,230	8,468	40,818	8,788
% change from preceding year	-7.1	-6.2	-14.6	-16.9	-21.8	-7.3	12.7	-13.6	-37.8	-22.8	-14.2	-18.2
Advances	9,422	14,916	3,364	14,217	2,810	6,408	2,518	3,108	16,513	6,235	35,870	7,151
% change from preceding year	-13.5	-8.5	-35.8	-26.8	-31.0	-11.6	-26.0	-48.4	-37.1	-35.5	-13.7	-25.1
Capital Stock	852	1,375	378	1,429	501	446	565	367	1,217	553	3,002	581
% change from preceding year	-0.9	-8.0	-34.1	-12.4	-10.9	-14.7	-8.1	-22.2	-44.8	-21.7	-9.3	-8.0
Total Capital	867	1,406	382	1,473	517	493	585	408	1,282	579	3,081	638
% change from preceding year	-12.6	-20.7	-43.9	-25.0	-29.3	-26.2	-23.4	-34.8	-48.9	-31.6	-19.3	-18.7
Capital/Asset Ratio	7.5	8.0	6.5	7.4	10.2	6.6	8.2	6.6	6.0	6.8	7.6	7.3
Capital/Asset Ratio July, 1989	8.0	9.5	9.9	8.2	11.3	8.3	12.1	8.8	7.4	7.7	8.1	7.3

Table 4

SELECTED INCOME ITEMS FOR REGIONAL RHB'S
January - July 1990
(\$ millions)

	BOSTON	NY	PHIL	ATL	CINC	IND	CHI	DES	DAL	TOP	SP	SEA
Net Income	63.5	84.7	33.0	109.2	27.9	40.4	33.7	26.5	100.5	56.2	237.0	59.8
$\downarrow$ change from same period last year	-16.5	-21.2	-38.5	-17.5	-32.1	-21.2	-22.1	-39.0	-43.8	-13.1	-22.2	12.8
Adverces Income	510.7	753.2	189.0	770.0	163.2	357.3	138.4	203.2	1,020.4	387.5	1,919.5	441.9
$\downarrow$ change from same period last year	-12.6	-13.1	-34.4	-27.2	-29.3	-11.5	-29.2	-39.8	-28.6	-26.6	-13.1	-12.1
Ratio Of Net Income To End Of Period Assets (Percent; Annualized)	.94	.82	.94	.94	.94	.93	.82	.74	.81	1.13	.99	1.17
Ratio Of Net Income To Total Capital (Percent; Annualized)	12.5	10.3	14.4	12.7	9.3	14.1	9.9	11.1	13.4	16.6	13.2	16.1

Table 5

SOURCES OUSINING TO SAV-INSURED INSTITUTIONS
March 31, 1990
 (\$ millions)

	REASON	NR	PUTT	ATL	CNC	IND	CHI	DES	INL	TOP	SF	SEA
Advances	9,969	14,698	3,501	14,775	3,238	6,604	2,725	4,014	20,469	7,665	36,461	8,735
Advances To RUC Institutions	227	2,305	1,207	2,086	594	20	400	1,044	5,422	3,780	3,939	1,720
% Of Total	2.3	15.7	34.5	14.1	18.0	0.3	14.7	26.0	26.5	46.3	10.8	19.7
Advances To Other Insolvent Institutions	233	1,944	538	2,506	177	1	367	802	5,646	267	1,036	1,970
% Of Total	2.3	13.2	15.4	17.0	5.5	—	13.5	20.0	27.6	3.5	2.8	22.6
Advances To Institutions With Cap/Asset Ratios Between 0 and 3%	467	4,791	337	3,262	828	1,826	315	829	6,079	1,997	7,988	165
% Of Total	4.7	32.6	9.6	22.1	25.6	27.6	11.6	20.7	29.7	26.1	21.9	1.9
% Of Advances To Impaired Institutions	9.3	61.5	59.5	53.2	49.1	27.9	39.8	66.7	83.8	78.9	36.5	44.2

TESTIMONY

OF

SHELDON POLLOCK

CHAIRMAN OF THE BOARD AND CEO

OF THE NORTH AMERICAN BANK AND TRUST COMPANY

WATERBURY, CONNECTICUT

ON BEHALF OF THE

INDEPENDENT BANKERS ASSOCIATION OF AMERICA

ON

OVERSIGHT HEARING ON THE FEDERAL HOME LOAN BANK SYSTEM

BEFORE THE

SUBCOMMITTEE ON GENERAL OVERSIGHT AND INVESTIGATIONS

UNITED STATES HOUSE OF REPRESENTATIVES

WEDNESDAY, OCTOBER 10, 1990
WASHINGTON, D.C.

Mr. Chairman, my name is Sheldon Pollock, and I am Chairman of the Board and CEO of The North American Bank and Trust Company of Waterbury, Connecticut. I am appearing today on behalf of the Independent Bankers Association of America, the only national trade association that exclusively represents the interests of community financial institutions.

This is the second opportunity we have had to discuss the broader membership in the Federal Home Loan Banks provided for under the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA). A year ago, IBAA's treasurer Ed Sheldon, welcomed the change in the law that permitted community banks to join the Banks, and also to buy services from them. As he said then, community banks are becoming more and more involved in home lending and so it is appropriate that they be able to be involved with the Federal Home Loan Banks whose mission is to promote home ownership.

My testimony today will center around my bank's decision to join the Federal Home Loan Bank of Boston and what membership means to community banks around the country.

Our Decision to Join

A few years ago the banks in New England were strained for liquidity and lendable funds. In many cases, our loan to deposit ratios exceeded 90%. Competition for deposits was so intense that our deposit costs exceeded the national average. The choices available to commercial banks were to use the national brokered C.D. market or curtail lending. Yet thrifts had a very appealing alternative. They were able to use the advance window at the Federal Home Loan Bank. They used this option extensively. From the end of 1985 through 1989, advances in the Boston Region grew from about \$3.5 billion to \$10.2 billion.

To obtain similar access to these advances, our bank applied for membership in the Boston Bank. We contended that changes in Connecticut law had made savings banks -- which were eligible for membership -- and commercial banks functionally equivalent. The Federal Home Loan Bank Board in Washington did not agree with our legal analysis, but while our application was pending, we learned that Congress was considering opening membership to commercial banks.

As soon as FIRREA passed, we renewed our application and our bank was the first commercial bank member from New England. I understand that we were the second bank admitted nationally, right after Ed Sheldon's bank in Bremerton, Washington.

Advantages of Membership in New England

One of the purposes of this hearing is to find out if the commercial banks are finding Federal Home Loan Bank membership attractive. In our case and in the case of the commercial bank members from New England, the answer is yes.

The primary benefit of membership is the access it provides to reasonably priced money through the advance window. We can re-lend those funds into our community for housing and jobs. We have also been able to improve our ability to match assets and liabilities.

Through a wider membership base, the Federal Home Loan Banks will provide an excellent source of funds for capital short areas. Not only will this benefit housing and home ownership, but it will also provide much needed employment. This will help us meet our banks' responsibilities under the Community Reinvestment Act. With increasing emphasis put on CRA by the Congress and the regulators, every tool is important.

Since 1978, the Federal Home Loan Bank of Boston has offered programs for both affordable housing and community reinvestment, as have a number of other district banks. In New England, the Affordable Housing Program is particularly attractive because of the high price of housing there.

The Boston Bank now has three affordable housing and community investment programs, has provided direct investment in some projects, and has loaned money at low rates and even below market rates.

My judgment is that, in time, these programs will make a major impact in helping to provide more affordable housing stock in our nation.

The Federal Home Loan Bank of Boston has aggressively sought members over the years--perhaps more so than the other district banks. Interest among commercial banks in our area is high.

My personal experience is that the Boston Bank does not impose a great deal of red tape and that the Bank's staff is very gracious and helpful whenever any questions arise. We are able to arrange the funds we need over the phone. Borrowings can be used for liquidity, for affordable housing, and for any other worth-while purpose. And, they can be at a fixed or variable rate. In short, the Bank's programs are very flexible.

Our Connecticut Community Bankers Association, which is associated with the IBAA, sponsored two well-attended seminars on membership benefits. As a result of those seminars, the FIRREA law and other membership marketing efforts, the Boston Bank had over 100 inquiries about membership from financial institutions. Five have joined and fourteen applications are winding their way through the system.

These new members may not immediately boost demand for advances, however. We are in a recession in New England and many banks are trying to shrink. As our loan demand decreases, our funding requirements can be supplied by local depositors. Eventually, this will turn around.

Membership Nationwide

Some bankers in other areas of the country have told me that they were reluctant to join the System as long as their deposits cost less than the comparable rate for advances. I have explained that the advances can provide an economical source of funds in times of high loan demand. If the Federal Home Loan Banks take a more aggressive approach to membership--and I understand they are--I'm sure more commercial banks will gladly join. After all, community commercial banks are a vital source of home mortgage lending in this country. In many communities, they are the only source for home mortgages.

Surveys by the American Banker, as well as the IBAA, have indicated that commercial banks are becoming even more involved in home lending. We recognize this and the IBAA is close to establishing a mortgage corporation which will seek to provide community banks with a consistent and reliable secondary mortgage outlet. Federal Home Loan Bank membership could provide a useful complement to this new IBAA service.

Recognizing that there has been a decrease in borrowing from the FHL Banks, they have recently inaugurated a series of focus groups around the country to develop programs to offer to banks. New products will undoubtedly increase participation. In the focus group I attended, bankers emphasized that price of services is a major factor in their decision to join the system.

FIRREA's membership requirements for commercial banks has dampened commercial bank membership interest. Commercial bank members may join a Federal Home Loan Bank if they have 10% of their assets in mortgages, but are required to purchase stock as if they had 30% commitment.

Also, the System Banks must conform to an overall limit that provides that non-QTL members primarily commercial banks, cannot borrow more than 30% of the total advances. While this is not a current problem it could become one if a larger commercial bank joined and borrowed so heavily that further non-QTL borrowings were not permitted. This would eliminate access for smaller, community-based banks as well as other non-QTL members. Worse, it is likely to occur when other lendable funds are in short supply.

I understand that changes in the stock purchase requirement and the lending limits are under consideration in Congress. If these changes make membership more attractive to commercial banks, it could benefit everyone concerned, including the Federal Home Loan Banks, their current members, as well as the commercial banks and their customers.

We continue to believe that Federal Home Loan Bank stock is a good investment. For the eight months ended August 31, 1990, the System Banks had a return on average assets of 11.89% and a capital to total asset ratio of 7.3%. Although advances decreased 22%,

deposits increased 18%. Remember, these deposits are not insured. In my opinion, I doubt that the members would place so much money in the System Banks if they lacked confidence in them. I also understand that on July 11, 1989, the accounting firm Deloitte, Haskins & Sells said that member banks could continue to carry the stock at par unless the System Banks are required to make too great a contribution to the thrift bailout.

Another question that we were asked to discuss was whether or not the number of district banks should be altered. While I'm not an expert in this area, there is one observation that I'd respectfully ask that you keep in mind when any changes are discussed. Whenever a bank makes loans in its own market area, loan losses are usually far less than when it lends outside of its normal trading areas. I would judge the same to be true with respect to the Regional Federal Home Loan Banks. The Boston Federal Home Loan Bank has an excellent record of lending in its home area of New England.

Conclusion

From this testimony, you can see that we find membership attractive. Our dividend rate from The Boston Bank has been running between 9.25% and 10.42%. It is well-managed and financially sound. We have access to attractive borrowing programs to help our community. When we have borrowed, it was done with dispatch. The Banks are trying to develop even more attractive programs. To induce other banks to join, they must keep the borrowing costs close to other funding sources available to us. And, our borrowing needs will depend on the condition of the economy. If the current recession deepens, borrowing at the advance windows will decrease. Over time, however, Federal Home Loan Bank membership should be good for our banks as well as our communities.

Mr. Chairman, I appreciate this opportunity to testify about our bank's experience in the Federal Home Loan Bank System. As community banks become more and more involved in home lending, we welcome the Federal Home Loan Banks' initiative in seeking to involve our banks in their programs. If they are successful, it will work to the benefit of all concerned.

Credit Union National Association, Inc.

805 15th Street, NW, Suite 300, Washington, DC 20005-2207, 202-682-4200



October 22, 1990

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The Honorable Carroll Hubbard, Jr.
 Chairman
 House Banking Subcommittee on General
 Oversight and Investigations
 B304 Rayburn House Office Building
 Washington, D.C. 20515

Dear Mr. Chairman:

The Credit Union National Association and Affiliates (CUNA), which through state member leagues represents 90% of all credit unions, appreciates this opportunity to provide our comments on the attractiveness of Federal Home Loan Bank membership for credit unions. Through over 52 leagues, CUNA represents 8,800 federal credit unions, 6,300 state credit unions and the more than 60 million credit union members they represent.

Title VII of the Financial Institution Reform, Recovery and Enforcement Act of 1989 (PL 101-73) authorizes credit unions to become Federal Home Loan Bank members under certain conditions. The law provides for a two-prong eligibility test for credit unions. In order to be eligible credit unions must: (1) Be federally insured; and (2) Meet a "qualified thrift lender" test by having at least 10% of its total assets in residential mortgage loans and be in sound financial condition and well managed. To become a member a credit union that qualifies must also purchase stock in a Federal Home Loan Bank.

Mr. Chairman, as you know, the House Banking Committee did not have an opportunity to conduct hearings on the amendments in Title VII concerning credit union membership in the Federal Home Loan Bank System before FIRREA was enacted. CUNA did not request these amendments and was not consulted about the need and/or interest among credit unions for the services provided by the Federal Home Loan Bank System. Since the enactment of the Financial Institutions Reform, Recovery and Enforcement Act in 1989, only one credit union has been accepted for FHLB membership although some applications for membership are pending.

Although CUNA did not endorse these amendments prior to the enactment of FIRREA we welcome any provisions that allow credit unions to serve better the housing needs of their members and to obtain share draft processing services at reasonable cost regardless of the vendor offering such services. Therefore, we commend the efforts of you and your colleagues in offering an alternative source for liquidity and services for the more than 35% of all CUNA members that offer first mortgage loans to members.

In order to promote our mutual goals of accommodating the needs of mortgage lenders, CUNA has made inquiries of the Federal Housing Finance Board, the agency which has been given authority over the individual Federal Home Loan Bank under the provisions of FIRREA, regarding certain ambiguities and confusion in the new law concerning FHLB membership for credit unions. In CUNA's first correspondence with the Federal Housing Finance Board on October 19, 1989, we commented that according to our reading of FIRREA, in order for a credit union to buy collection and settlement services from a Federal Home Loan Bank, the credit union would not only have to be federally insured, but also have 10% of its assets in residential mortgage loans. In that same October 19 correspondence, CUNA noted that not all Federal Home Loan Bank staff agree with our interpretation based on inquiries received from some CUNA members who were told by FHLB staff that they are eligible to buy share draft processing services from FHLBB if they are federally insured, regardless of the composition of their loan portfolio. CUNA asked for clarification from the Federal Housing Finance Board. To date, there has been no response.

In subsequent written correspondence and telephone conversations CUNA has requested a clarification on this issue as well as others concerning stock subscription requirements as well as the process for obtaining advances and services. In addition, CUNA has expressed a concern about warnings CUNA witnesses were given by Members of Congress during the hearings on FIRREA about the increase in real estate lending by credit unions. Both CUNA and our federal regulatory agency, the National Credit Union Agency (NCUA) have taken steps to insure that real estate lending by credit unions is done in a deliberately and orderly fashion, and CUNA has expressed a concern to the Federal Housing Finance Board that promotion of credit union membership on the Federal Home Loan Bank System may be viewed by some credit unions as an official encouragement to escalate the amount of real estate lending by credit unions. So far none of CUNA's inquiries or concerns have been addressed by the Federal Housing Finance Board.

In conclusion, Mr. Chairman, CUNA appreciates this opportunity to comment and sincerely hopes that you find our views useful. Please contact our Washington office (682-4200) if you need any addition information.

Sincerely,

Charles O. Zuver

Charles O. Zuver
Senior Vice President and
Director, Governmental Affairs

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